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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1946

No. 287

J. ROBERT BAZLEY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED JULY 11, 1946.

CERTIORARI GRANTED OCTOBER 14, 1946.

IN THE

United States Circuit Court of Appeals

FOR THE THIRD CIRCUIT.

No. 8947.

J. ROBERT BAZLEY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition to Review the Decision of The Tax Court of the United States.

Appendix to Brief for Petitioner.

HENRY S. DRINKER,
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Attorneys for Petitioner.

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Appendix.

RELEVANT DOCKET ENTRIES.

May 5, 1943.	Petition received and filed. Taxpayer notified. Fee paid.
May 5, 1943.	Request for Circuit hearing in Philadelphia, Pa., filed by taxpayer. 5/6/43 Granted.
May 6, 1943.	Copy of petition served on General Counsel.
June 26, 1943.	Answer filed by General Counsel.
June 30, 1943.	Copy of answer served on taxpayer—Philadelphia, Pa.
July 26, 1944.	Hearing set Sept. 11, 1944—Philadelphia, Pa.
Sept. 12, 1944.	Hearing had before Judge Opper on merits. Motion to consolidate filed and granted. Stipulation of facts, appearance of Frederick E. S. Morrison and Calvin H. Rankin filed. Petitioner's brief due 10/27/44, Respondent's 10/27/44, replies 11/11/44.
Sept. 23, 1944.	Transcript of hearing 9/12/44 filed.
Oct. 25, 1944.	Motion to correct official report filed by taxpayer. 10/26/44 granted.
Oct. 27, 1944.	Brief filed by taxpayer. Copy served 11/14/44.
Oct. 27, 1944.	Motion for extension to 11/20/44 to file brief filed by General Counsel. 10/28/44 Granted.

Nov. 14, 1944.	Brief filed by General Counsel.
Nov. 28, 1944.	Motion for extension to Dec. 15, 1944 to file reply brief, filed by General Counsel. 11/29/44 Granted.
Nov. 30, 1944.	Motion for extension to Dec. 15, 1944 to file reply brief filed by taxpayer. 11/30/44 Granted.
Dec. 14, 1944.	Reply brief filed by taxpayer. 12/14/44 copy served.
Dec. 20, 1944.	Motion for leave to file the attached reply brief, reply brief lodged, filed by General Counsel. 12/21/44 Granted.
Jan. 19, 1945.	Motion for leave to substitute the attached page 5 in the above reply brief filed by General Counsel. 1/22/45 Granted.
Feb. 28, 1945.	Findings of fact and opinion rendered, Opper, J. Decision will be entered for respondent.
Mar. 2, 1945.	Decision entered, Opper, J., Div. 14. 3/1/45 Copy served.
Apr. ~~12~~, 1945.	Petition for review by U. S. Circuit Court of Appeals, Third Circuit filed by taxpayer.
Apr. 12, 1945.	Notice of filing petition for review sent to J.-P. Wenchel filed.
Apr. 13, 1945.	Proof of service of petition for review filed.
Apr. 23, 1945.	Designation of record filed by taxpayer, with proof of service thereon.

PETITION.

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, signed by E. A. McGinnes, Acting Revenue Agent in Charge (Symbols SN-IT-1, BMN/pk), dated February 11, 1943, and as a basis of this proceeding alleges as follows:

I. Petitioner is a citizen of the United States residing in Pottsville, Pennsylvania. The return of the Petitioner for the calendar year 1939, the period here involved, was filed on or about March 15, 1940 with the Collector of Internal Revenue for the First District of Pennsylvania.

II. A notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the Petitioner on February 11, 1943.

III. The tax in controversy is income tax for the calendar year 1939 in the amount of $214,170.52, which is the amount of deficiency erroneously determined by Respondent.

IV. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

The Commissioner of Internal Revenue in computing Petitioner's net income for the year 1939 erroneously and illegally

(1) added to Petitioner's taxable net income the sum of $319,200. on the alleged ground as set forth in the deficiency letter (see Exhibit A—p. 2 attached)

> "(a) Other income has been increased $319,200. representing the fair market value of bonds of J. Robert Bazley, Inc. received in exchange of common stock of that corporation.
>
> "It is held that in this transaction, you received income of $319,200. which is taxable in your return for the year 1939."

Whereas Petitioner alleges that no taxable income or gain was realized upon the exchange by him in 1939 of 798 shares of common stock of $100. par value each of J. Robert Bazley, Inc. for $319,200. principal amount of 20 year 6% debenture bonds, and 3990 shares of new common stock without par value of said corporation for the reason that no gain or loss is recognized by the provisions of Sections 112 (b) (3) and (g) of the Internal Revenue Code;

or (2) in the alternative, the Commissioner erroneously determined the fair market value of the $319,200. principal amount of 20 year 6% debenture bonds of J. Robert Bazley, Inc. at $319,200., whereas Petitioner alleges that said fair market value was not in excess of 50% of the principal amount of said bonds;

or (3) in the further alternative, the Commissioner erroneously determined that such alleged income (which Petitioner does not admit) is taxable as ordinary income, whereas if it is held that income or gain was realized by Petitioner upon the exchange by him of stock by J. Robert Bazley, Inc. for stock and bonds of said corporation as above set forth, then such income or gain is subject only to tax at the capital gain rate provided by Section 117 of the Internal Revenue Code.

V. The facts upon which Petitioner relies as the basis of this proceeding are as follows:

(1) On May 1, 1930 Petitioner became the owner of 998 shares of common stock of $100. par value each of J. Robert Bazley, Inc. at a cost to Petitioner of $100. per share, of which he continued to own and did own 798 shares up to the time of the recapitalization of J. Robert Bazley, Inc. in 1939, which recapitalization is hereinafter more fully set forth.

(2) On February 6, 1939 the Board of Directors of J. Robert Bazley, Inc., at a special meeting held at the principal office of the company at Port Carbon, Pa., unanimously adopted a Plan of Reorganization and Recapitalization dated as of February 1, 1939.

(3) The Plan of Reorganization and Recapitalization was unanimously approved by the stockholders of J. Robert Bazley, Inc. at a special meeting held at the office of the company at Port Carbon, Pa. on February 16, 1939.

(4) Under the Plan of Reorganization and Recapitalization the capital stock of the company was increased from 1000 shares of common stock of a par value of $100. per share to 5000 shares of common stock of no par value, with a stated value of $300,000., and the corporate indebtedness was increased from nothing to $400,000. represented by an issue of 6% debenture bonds due February 1, 1959. The plan further provided that the 1000 shares of outstanding common stock of the corporation were to be exchanged for the 5000 shares of the new common stock without par value and the $400,000. principal amount of debenture bond securities.

(5) Pursuant to the Plan of Reorganization and Recapitalization, the corporation exchanged the 5000 shares of new common stock without par value and $400,000. of principal amount of debenture bonds for the 1000 shares of common stock outstanding. The exchange was made on the basis of 5 shares of new common stock without par value and $400. of debenture bonds for each share of old common stock outstanding. The 1000 shares of old common stock were then cancelled on the books of the corporation.

(6) The Petitioner in April, 1939, pursuant to and in accordance with the terms of the Plan of Reorganization and Recapitalization received in exchange for his 798 shares of $100. par value common stock of J. Robert Bazley, Inc., 3990 shares of no par value common stock and $319,200. principal amount of 20 year 6% debenture

bonds of the same corporation. The Petitioner contends that he did not realize any taxable income as a result of this exchange since this transaction constituted a reorganization and was nontaxable within the meaning of Section 112 (b) (3) and 112 (g) of the Internal Revenue Code. The Commissioner erroneously included in the taxable income of Petitioner for the year 1939 the sum of $319,200. representing the principal amount of the debenture bonds received in the above exchange.

In the alternative, if it be held that the Petitioner realized taxable income in 1939 to the extent of the fair market value of the debenture bonds received in the exchange, then the Petitioner contends that the Commissioner erred in determining the fair market value of the $319,200. principal amount of 20 year 6% debenture bonds of J. Robert Bazley, Inc. at $319,200. The Petitioner contends that the fair market value of the $319,200. principal amount of 20 year 6% debenture bonds of J. Robert Bazley, Inc. was not in excess of $159,600.

In the further alternative, if it be held that Petitioner realized taxable income or gain in 1939 as a result of the foregoing exchange, then Petitioner contends that the Commissioner erred in determining that such income or gain was ordinary income instead of capital gain as provided by Section 117 of the Internal Revenue Code.

WHEREFORE, Petitioner prays that your court will hear the proceedings and determine

(1) That the Petitioner did not realize taxable income in the amount of $319,200., or in any amount, as a result of his exchange of 798 shares of common stock of J. Robert Bazley, Inc. for 3990 shares of no par value common stock and $319,200. principal amount of 20 year 6% debenture bonds of the same corporation;

or, in the alternative, that the fair market value of $319,200. principal amount of 20 year 6% debenture bonds of J. Robert Bazley, Inc. was not in excess of $159,600;

or, in the further alternative, if it be held that Petitioner realized taxable income or gain as a result of the foregoing exchange, then such gain is taxable at the capital gain rate of the Internal Revenue Code;

(2) that there is no deficiency owing by the Petitioner for the year 1939.

Respectfully submitted,

(Sgd.) FREDERICK E. S. MORRISON,
Frederick E. S. Morrison,
(Sgd.) CALVIN H. RANKIN,
Calvin H. Rankin,
(Sgd.) LESLIE M. SWOPE,
Leslie M. Swope,
Counsel for Petitioner,
1429 Walnut Street,
Philadelphia, Pa.

COMMONWEALTH OF PENNSYLVANIA, }
COUNTY OF SCHUYLKILL, } *ss.:*

J. ROBERT BAZLEY, being duly sworn according to law, deposes and says that he is the Petitioner above-named; that he has read the foregoing Petition and is familiar with the statements contained therein; and that the facts stated therein are true.

J. ROBERT BAZLEY.

Sworn to and subscribed before me this 4th day of May, A. D., 1943.

RUSSELL L. HERSHBERGER,
Notary Public.

(Seal)

My Commission Expires March 8, 1947.

EXHIBIT A.

SN-IT-1

TREASURY DEPARTMENT
Internal Revenue Service
Philadelphia, Pa.

February 11, 1943.

Office of
Internal Revenue Agent in Charge
Room 1100 Gimbel Building
Philadelphia Division
Mr. J. Robert Bazley,
Post Office Box 117,
Pottsville, Pennsylvania.

Sir:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1939, discloses a deficiency of $214,170.52, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to this office. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

Guy T. Helvering,
Commissioner,

By
(Sgd) E. A. McGinnes
Acting Revenue Agent in Charge

Enclosures:

Statement
Form of Waiver
Form 1276

BMN/pk

STATEMENT

J. Robert Bazley,
Post Office Box 117,
Pottsville, Pennsylvania.

Tax Liability for Taxable Year Ended
December 31, 1939

	Liability	Assessed	Deficiency
Income Tax	$248,712.73	$34,542.21	$214,170.52

In making this determination of your income tax liability careful consideration has been given to the report of examination dated January 1, 1943, to your protest dated January 15, 1943, and to the statements made at conference held February 8, 1943.

A copy of this letter and statement has been mailed to your representative, Mr. William Reuben Lefferts, Lincoln-Liberty Building, Philadelphia, Pa., in accordance with the authority contained in the power of attorney executed by you and on file with this office.

Adjustments to Net Income

Net income as disclosed by return		$100,872.35
Unallowable deductions and additional income:		
(a) Other income	$319,200.00	
(b) other deductions	371.72	319,571.72
Net income adjusted		$420,444.07

Explanation of Adjustments

(a) Other income has been increased $319,200.00, representing the fair market value of bonds of J. Robert Bazley, Inc., received in exchange of common stock of that corporation.

It is held that in this transaction, you received income of $319,200.00 which is taxable in your return for the year 1939.

(b) Deduction for personal expenses disallowed.

Computation of Tax

Net income adjusted		$420,444.07
Plus: Net long-term loss		5,121.12
Ordinary net income		425,565.19
Less: Personal exemption	$2,500.00	
Credit for dependent	400.00	2,900.00
Balance (surtax net income)		422,665.19
Less: Earned income credit		1,400.00
Net income subject to normal tax		421,265.19
Normal tax at 4 percent on $421,265.19		16,850.61
Surtax on $422,665.19		233,412.33
Partial tax		250,262.94
Less: 30 percent of $5,121.12 (net long term loss)		1,536.34
Total tax		248,726.60
Less: Income tax paid at source		13.87
Correct income tax liability		248,712.73
Income tax assessed:		
Original, Account #201821	34,311.74	
Additional, Account #515668	230.47	34,542.21
Deficiency of income tax		$214,170.52

ANSWER.

Now comes the Commissioner of Internal Revenue by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition in the above-entitled proceeding admits and denies as follows:

I. Admits the allegations of the first sentence of paragraph I of the petition; admits that the return of petitioner for the calendar year 1939 was filed with the Collector of Internal Revenue for the First District of Pennsylvania; denies the remaining allegations of said paragraph I.

II. Admits the allegations of paragraph II of the petition.

III. Admits that the tax in controversy is income tax for the calendar year 1939; denies the remaining allegations of paragraph III of the petition.

IV. Denies the allegations of paragraph IV of the petition and the allegations of all divisions and subdivisions of said paragraph IV.

V. (1) Admits that prior to April, 1939, petitioner owned 798 shares of common stock, of $100.00 par value each, of J. Robert Bazley, Inc.; denies the remaining allegations of paragraph V (1) of the petition.

(2) and (3) Denies the allegations of paragraph V (2) and (3) of the petition.

(4) Admits that the capital stock of J. Robert Bazley, Inc., was increased from 1,000 shares of common stock of a par value of $100.00 per share to 5,000 shares of common stock of no par value, with a stated value of $300,000.00, and the corporate indebtedness of said corporation was increased from nothing to $400,000.00, represented by an issue of 6% debenture bonds due February 1, 1959; denies the remaining allegations of paragraph V (4) of the petition.

(5) Admits that said corporation exchanged 5,000 shares of new common stock without par value and $400,-

000.00 of principal amount of debenture bonds for the 1,000 shares of old common stock outstanding; admits that the exchange was made on the basis of 5 shares of new common stock without par value and $400.00 of debenture bonds for each share of old common stock; admits that the 1,000 shares of old common stock were then cancelled; denies the remaining allegations of paragraph V (5) of the petition.

(6) Admits that in April 1939, petitioner received in exchange for his 798 shares of $100.00 par value old common stock of J. Robert Bazley, Inc., 3,990 shares of no par new common stock of said corporation and $319,200.00 principal amount of 20-year 6% debenture bonds of said corporation; denies the remaining allegations of the first sentence of paragraph V (6) of the petition. Respondent denies that petitioner's contention made in the second sentence of paragraph V (6) of the petition is justified in law or in fact and opposes said contention; denies the allegations of the third sentence of paragraph V (6) of the petition; denies the remaining allegations and opposes the remaining contentions made by petitioner in said paragraph V (6) of the petition.

VI. Denies generally each and every allegation of the petition not hereinabove specifically admitted, qualified or denied.

WHEREFORE, respondent prays that the petition be denied.

(Sgd.) J. P. WENCHEL,
B. F.
J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
HARTFORD ALLEN,
Division Counsel,
BROOKS FULLERTON,
Special Attorney,
Bureau of Internal Revenue.

STIPULATION OF FACTS.

IT IS HEREBY STIPULATED and AGREED by and between the parties hereto, by their respective attorneys, that the following statements may be taken as facts and that the same may be considered by the Court as offered in evidence by the parties to this proceeding; provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts stipulated herein:

1. The petitioners are citizens of the United States and reside in Pottsville, Pennsylvania.

2. Each of the petitioners for the calendar year 1939 filed a separate income tax return with the Collector of Internal Revenue for the First District of Pennsylvania on or before March 15, 1940. The books of each of said petitioners are kept and their respective income tax returns for the year 1939 were filed on the cash basis, except for the hauling business which J. Robert Bazley conducted as sole proprietor and which is on an accrual basis.

3. (b) The notice of deficiency dated February 11, 1943, which is addressed to petitioner J. Robert Bazley and which forms the basis of this appeal, proposes a deficiency in income tax for the year 1939 in the amount of $214,170.52.

ISSUE—*Reorganization of J. Robert Bazley, Inc.*

4. J. Robert Bazley, Inc. was incorporated under the laws of the Commonwealth of Pennsylvania on May 1, 1930, with an authorized capital of 1,000 shares of a par value of $100 per share. On February 1, 1939, and at all times hereinafter referred to, this stock was owned in the following amounts and by the following persons:

Name	Number of Shares
J. Robert Bazley	798
Alice H. Bazley	201
Alfred Day	1

all of whom, at all times herein material, constituted the Board of Directors of said corporation.

5. On February 6, 1939, at a special meeting of the Board of Directors of J. Robert Bazley, Inc. held at the principal office of the company at Port Carbon, Pennsylvania, the Board of Directors duly adopted an agreement entitled "Plan of Reorganization (Recapitalization or Reorganization)" dated as of February 1, 1939, hereinafter referred to as the Agreement. A true and correct copy of the minutes of said special meeting of February 6, 1939, of the Board of Directors of J. Robert Bazley, Inc. is attached hereto, made a part hereof, and marked Exhibit 1-A, and a true and correct copy of the said Agreement, considered and adopted is attached hereto, made a part hereof, and marked Exhibit 2-B.

6. On February 16, 1939, all the owners of the outstanding capital stock of J. Robert Bazley, Inc. held a special meeting at the office of the company at Port Carbon, Pennsylvania, and unanimously approved the said Agreement. A true and correct copy of the minutes of February 16, 1939, of the special meeting of the stockholders of J. Robert Bazley, Inc. together with a specimen form of the debenture bonds approved in said meeting is attached hereto, made a part hereof, and marked Exhibit 3-C.

7. Under the said Agreement as adopted by the directors and approved by the shareholders, the capital stock of the company was duly increased from 1,000 shares common stock of a par value of $100 per share to 5,000 shares common stock of no par value with a stated value of $300,000 and the corporate indebtedness was increased from nothing to $400,000, represented by an issue of Twenty Year Six Per Cent. Debenture Bonds of said J. Robert Bazley, Inc. due February 1, 1959.

8. On March 6, 1939, the Commonwealth of Pennsylvania approved the amendment to the company's articles

of incorporation increasing the authorized capital stock of the said corporation from 1,000 shares of common stock of a par value of $100 per share to 5,000 shares of common stock of no par value, the stated capital applicable to which is $300,000.

9. In accordance with the resolution adopted at the meeting of the shareholders of J. Robert Bazley, Inc. held on February 16, 1939, the capital structure of the company, which prior to the consummation of the terms of said Agreement, was as follows:

1,000 shares common stock of par value of $100 per share	$100,000.00
Earned Surplus	855,783.82
Total	$955,783.82

after the consummation thereof, the capital structure was changed as shown by the corporation's books of account, as follows:

5,000 shares common stock without nominal or par value, the stated capital applicable to which is	$300,000.00
Earned Surplus	255,783.82
Outstanding Debenture Bonds	400,000.00
Total	$955,783.82

10. On March 16, 1939, the stockholders of J. Robert Bazley, Inc. pursuant to the terms of said Agreement delivered to the corporation the 1,000 shares of common stock previously held by them and received therefor from the corporation the 5,000 shares of its new common stock of no par value and debenture bonds in the aggregate principal amount of $400,000, dated February 1, 1939, and due February 1, 1959. Thereupon the 1,000 shares of common stock of the par value of $100 per share previously outstanding were duly cancelled by the corporation.

12. Petitioner J. Robert Bazley on March 16, 1939, pursuant to and in accordance with the terms of the Agreement duly received for his 798 shares of $100 par value common stock of J. Robert Bazley, Inc. having a basis of $79,800 (all of which had been held by him since May 4, 1930) 3,990 shares of no par value common stock and $319,200 principal amount of Twenty Year Six Per Cent Debenture Bonds of J. Robert Bazley, Inc.

13. There is attached hereto, made a part hereof, and marked Exhibit 4-D a true and correct copy of the balance sheets of J. Robert Bazley, Inc. per books as of the beginning and end of the corporation's fiscal year ending April 30, 1939.

14. In the respective income tax returns filed by the petitioners for the calendar year 1939 neither of the petitioners reflected any taxable income or gain or deductible loss arising out of the transaction or receipt of the securities referred to in paragraphs 11 and 12, supra, on the alleged theory, which is their present contention, that no taxable income or gain or deductible loss was realized as the result of the exchange since the transaction constituted a reorganization within the provisions of Section 112 (g) of the Internal Revenue Code and that therefore no gain or loss should be recognized upon the exchange of stock of J. Robert Bazley, Inc. for stock and securities of J. Robert Bazley, Inc. in accordance with the provisions of Section 112 (b) (3) of the Internal Revenue Code.

16. The Commissioner of Internal Revenue by the Deficiency Notice increased the taxable income shown on the return of J. Robert Bazley by the amount of $319,200, explaining the adjustment as follows:

> "(a) Other income has been increased $319,200 representing the fair market value of bonds of J. Robert Bazley, Inc. received in exchange of common stock of that corporation."

17. In accordance with the terms of the Agreement J. Robert Bazley, Inc. agreed to and did pay all expenses incident to and connected with the consummation of said Agreement and agreed to and did pay all taxes, Federal and State, including stamp taxes, incident to the issuance by the corporation of the new stock and Twenty Year Six Per Cent Debenture Bonds.

18. The 5,000 shares of new common stock and the $400,000 face amount of Twenty Year Six Per Cent Debenture Bonds issued by J. Robert Bazley, Inc. to its shareholders on March 16, 1939 for the 1,000 shares of $100 par value common stock of said company had fair market values at that time of not less than $300,000 for the said 5,000 shares of common stock and $400,000 for the said debenture bonds.

FREDERICK E. S. MORRISON,
Counsel for Petitioners.

J. P. WENCHEL,
A
Chief Counsel, Bureau of Internal Revenue.

EXHIBIT 1-A.

Minutes of a special meeting of the Board of Directors of J. Robert Bazley, Inc., held at the principal office of the company at Port Carbon, Pennsylvania, on February 6th, 1939, at 10 o'clock A. M., notice of the meeting having been waived by the Directors.

There were present in person: J. Robert Bazley, Alice H. Bazley, and Alfred Day, constituting the entire Board.

Mr. J. Robert Bazley acted as chairman and Mr. Alfred Day acted as secretary of the meeting.

The chairman announced that the meeting was called to discuss the advisability of reorganizing and recapitalizing the corporation. He read to the Board a proposed Plan of Reorganization which, he suggested, in his opinion

would be advisable for the corporation to consummate. He advised the meeting that the suggested Plan had been exhaustively discussed with Roscoe Koch, Esq., counsel for the company, and with Wesley, Wagoner, Trautman & McWilliams, who were especially retained for their advice. He stated that he had moreover gone into the details at great length with the company's accountants, Wm. Reuben Lefferts & Co., and that it was the consensus of opinion of counsel and the accountants that the Plan was advantageous to the corporation and its stockholders, and that it would be to the advantage of all parties to adopt the same. The Plan was analyzed, paragraph by paragraph, by the Directors and, upon motion duly seconded, the following resolution was unanimously adopted:

RESOLVED that, in the opinion of the Board of Directors, it is to the advantage of the corporation and its stockholders that the Plan of Reorganization dated as of February 1st, 1939, be adopted; and be it further

RESOLVED that a copy of said Plan be attached to the minutes of this meeting.

The chairman stated that, in order to consummate the Plan, the charter of the corporation would have to be amended to provide for the issue of the new no par value common stock and that the corporate indebtedness of the company would have to be increased to provide for the issuance of the Debenture bonds contemplated by the Plan, all of which require the action of the stockholders.

Upon motion, duly seconded, the following resolution was unanimously adopted:

RESOLVED that the formal corporate indebtedness of this company be increased from nothing to $400,000.00;

RESOLVED that a meeting of stockholders be called to convene at the general office of the company on the 16th day of February, 1939, to take action on approval or disapproval of the proposed increase of the formal indebtedness of this company, the notice required to be given by the Constitution and laws of this Commonwealth having been waived by the unanimous consent of the stockholders.

Upon motion, duly seconded, it was unanimously

RESOLVED that paragraph 7th of the Articles of Incorporation of this corporation be amended so as to read as follows:

The authorized capital stock of the corporation is 5,000 shares of common stock without par value, the stated capital applicable to which is $300,000.00.

RESOLVED FURTHER that a meeting of stockholders be called to convene at the general office of this company on the 16th day of February, 1939, to take action on approval or disapproval of the proposed amendment, the notice required to be given by the Constitution and laws of this Commonwealth having been waived by the unanimous consent of the stockholders.

Upon motion, duly seconded, it was unanimously

RESOLVED that Charles Shuster, Russell Hershberger, and Richard Evans be and they hereby are appointed judges of election to act as such at the meeting of stockholders to be held on February 16th, 1939, or any adjournment thereof.

There being no further business before the meeting, the same adjourned.

(Signed) Alfred Day
Secretary.

APPROVED:

S/ J. Robert Bazley
S/ Alice H. Bazley
S/ Alfred Day

EXHIBIT 2-B.

J. ROBERT BAZLEY, INC.

PLAN OF REORGANIZATION

DATED AS OF FEBRUARY 1, 1939

PRESENT CAPITALIZATION

As of February 1st, 1939, the corporation's capitalization is as follows:

1,000 shares of common capital stock of the par value of $100.00 per share	$100,000.00
Earned surplus	855,783.82
Total capital and surplus	$955,783.82

RECAPITALIZATION OR REORGANIZATION

The corporation shall reorganize its capital structure, as of February 1st, 1939, by the issuance of 5,000 shares of common capital stock of no par value (with a stated value of $300,000.00), earned surplus of $255,783.82, and $400,000.00 principal amount of six per cent. debenture bonds, the terms and provisions of which are as hereinafter stated.

The corporation shall issue, in exchange for the 1,000 shares of present outstanding common stock, 5,000 shares of the new common stock without par value and $400,000.00 principal amount of debenture bonds. Upon said exchange, the present outstanding common stock shall be cancelled so that, upon the consummation thereof, the capitalization of the company shall consist of 5,000 shares of common stock, without par value, the stated capital applicable to which is $300,000.00, earned surplus $255,783.82, and the corporation shall be subject to $400,000.00 principal amount of outstanding debenture bonds.

TERMS OF THE DEBENTURE BONDS

The debenture bonds will be limited to the aggregate principal amount of $400,000.00. They will be issuable in registered form only, without coupons, in denominations of $100.00 and any multiple of $100.00. They will be dated as of February 1st, 1939, which is the effective date of the reorganization, and will be payable February 1st, 1959. The debenture bonds will be callable, as a whole or in part, at any time on thirty days' notice at the principal amount thereof plus all accumulated and unpaid interest to the date of redemption. The corporation will pay, on April 30th of each year, beginning April 30th, 1939, interest upon the debenture bonds at the rate of six per cent. per annum, and the corporation will assume and pay the personal-property tax, not exceeding eight mills on the dollar, assessed against the holders of the bonds under the laws of the Commonwealth of Pennsylvania.

EFFECTIVE DATE OF REORGANIZATION

The effective date of the reorganization shall be February 1st, 1939. The exchange of securities as provided in the Plan shall be made at the office of the company at Port Carbon, Schuylkill County, Pennsylvania, within fifteen days from the approval of the reorganization by formal action of stockholders and by the Commonwealth of Pennsylvania's approval of the Amendment to the Articles of Incorporation.

The corporation will bear all expenses incident to and connected with the consummation of the Plan and will pay all taxes, federal and state, including stamp taxes incident to the issuance of the new stock and securities.

The corporation has hereunto affixed its corporate seal, duly attested, and the individual stockholders have caused their hands and seals to be affixed, indicating their several

and respective approvals of the aforesaid Plan, as of February 1st, 1939.

J. ROBERT BAZLEY, INC.,
By J. Robert Bazley
President

Attest: Alfred Day
Secretary

(Corporate Seal)

J. Robert Bazley
Alice H. Bazley
Alfred Day

EXHIBIT 3-C.

Minutes of a special meeting of the stockholders of J. Robert Bazley, Inc., held at the office of the company at Port Carbon, Pennsylvania, on February 16th, 1939, at 10 o'clock A. M., notice of the meeting having been waived by the unanimous consent of the stockholders.

There were present in person the following: J. Robert Bazley, Alice H. Bazley, and Alfred Day, constituting the owners of all the outstanding capital stock.

Mr. Bazley acted as chairman and Mr. Day as secretary of the meeting.

The chairman announced that the meeting was called in accordance with the resolutions adopted by the Board of Directors at their meeting on February 6th, 1939, to take formal action approving a proposed Plan of Reorganization of the company dated as of February 1st, 1939, and the consequent increase of the formal corporate indebtedness and proposed amendment to the Articles of Incorporation of the company.

Upon motion, duly seconded, it was unanimously

RESOLVED that the Plan of Reorganization dated as of February 1st, 1939, a copy of which is attached to the min-

utes of the meeting of the Board of Directors held February 6th, 1939, be and the same hereby is approved.

Upon motion, duly seconded, the following resolution was proposed:

RESOLVED that the formal corporate indebtedness of this company be increased from nothing to $400,000.00, said indebtedness to be represented by an issue of the company's six per cent. debenture bonds, the terms and provisions of which are more particularly set forth in said bonds, the form of which is hereby approved and a copy thereof attached to the minutes of this meeting.

The judges appointed by the Board of Directors took the vote on the above resolution and reported that there were voted in favor thereof 1,000 shares and thereagainst no shares.

The chairman thereupon announced that the resolution was adopted, and it was directed that the Judges' Return and the Waiver of Notice of the meeting executed by all the stockholders be attached to the minutes of this meeting.

Upon motion, duly seconded, the following resolution was proposed:

RESOLVED that paragraph 7th of the Articles of Incorporation of this corporation be and the same is hereby amended so as to read as follows:

> The authorized capital stock of the corporation is 5,000 shares of common stock without par value, the stated capital applicable to which is $300,000.00.

The judges appointed by the Board of Directors took the vote on the above resolution and reported that there were voted in favor thereof 1,000 shares and thereagainst no shares.

The chairman thereupon announced that the resolution was adopted, and it was directed that the Judges' Return and the Waiver of Notice of the meeting executed by all of the stockholders be attached to the minutes of this meeting.

Upon motion, duly seconded, it was

RESOLVED FURTHER that the president and secretary of the corporation be and they are hereby authorized, empowered, and directed to execute under the corporate seal of this corporation Articles of Amendment to the Articles of Incorporation and to file such Articles of Amendment with the Department of State of the Commonwealth of Pennsylvania.

On motion, it was directed that the said amendment be duly advertised.

The president stated that, should the amendment just adopted be approved by the Commonwealth of Pennsylvania, the company would immediately take steps, in accordance with the terms of the Plan of Reorganization, to issue the new common stock and the debenture bonds in exchange for the present outstanding common stock in the ratio of five shares of new common stock and $400.00 principal amount of debenture bonds in exchange for each share of the present outstanding common stock, and that upon the consummation of said exchange, the present common stock now outstanding would be cancelled. He stated that a formal resolution directing such exchange and the consequent reorganization of the corporation's capital structure was in order.

Upon motion, duly seconded, the following resolution was unanimously adopted:

RESOLVED that, upon the approval by the Commonwealth of Pennsylvania of the amendment to the company's Articles of Incorporation, the proper corporate officers shall take immediate steps to consummate the reorganization of the company in accordance with said Plan of Reorganization dated as of February 1st, 1939, and shall forthwith execute and deliver the 5,000 shares of the new non par value common stock and $400,000.00 principal amount of debenture bonds in exchange for the common stock now outstanding, consisting of 1,000 shares of the par value of $100.00 a

share, and that when said exchange has been completed, the present outstanding common stock be forthwith cancelled; and be it further

RESOLVED that the capital structure of the company, which as of February 1st, 1939, is as follows:

1,000 shares of common capital stock of the par value of $100.00 per share	$100,000.00
Earned surplus	855,783.82
Total capital and surplus	$955,783.82

be, upon the consummation of the said Plan of Reorganization, changed as of February 1st, 1939, so that it shall be as follows:

5,000 shares of common capital stock without nominal or par value, the stated capital applicable to which is	$300,000.00
Earned surplus	255,783.82
Outstanding debenture bonds	400,000.00
	$955,783.82

and be it further

RESOLVED that the company's accountants be directed to make the proper entries in the books and records of the company showing the reorganization as above set forth.

The chairman presented a form of common stock certificate proposed to be issued and, on motion duly seconded, it was unanimously

RESOLVED that the form of common stock certificate presented to the meeting be and the same hereby is approved and adopted.

Upon motion, duly seconded, it was unanimously

RESOLVED that the treasurer of the corporation be and he hereby is authorized and directed, on behalf of the cor-

poration, to cause the due registration of the debenture bonds hereinabove authorized and, as such registrar, to execute such papers and documents as may be required.

There being no further business before the meeting, the same adjourned.

Alfred Day
Secretary.

J. Robert Bazley, Inc.
Waiver of Notice

To the Directors of J. Robert Bazley, Inc.:

We, the undersigned, constituting the owners of all the outstanding capital stock of J. Robert Bazley, Inc., who are the holders of said stock to the amounts set opposite our several names, request that you, by resolution, declare that it is the desire of the corporation to increase its formal corporate indebtedness from nothing to $400,000.00, and to amend its Articles of Incorporation so as to increase the capital stock from 1,000 shares of the par value of $100.00 per share to 5,000 shares without nominal or par value, the stated capital applicable to such non par value shares to be $300,000.00. And we request that you, by resolution, call a meeting of the stockholders of the company to be held on the 16th day of February, 1939, for the purpose of voting for said increase in corporate indebtedness and said amendment to the Articles of Incorporation. And we do hereby waive the notice of such meeting of the stockholders, required to be given by the 7th section of the 16th Article of the Constitution of Pennsylvania, and by the laws thereof relating to the increase of capital stock or indebtedness of corporations, as well as by any by-law of the company requiring notice of such meeting to be given:

Name	No. of Shares
J. Robert Bazley	798
Alice H. Bazley	201
Alfred Day	1

COMMONWEALTH OF PENNSYLVANIA }
COUNTY OF PHILADELPHIA } ss.

ALFRED DAY, being duly sworn according to law, doth depose and say that he is secretary of J. Robert Bazley, Inc., that the stock ledger of said company is in his custody and under his control, and that the list of stockholders given in the above waiver of notice of a meeting to be held for the purpose of voting for or against the increase of the formal corporate indebtedness of the company and for the amendment to its Articles of Incorporation, is a complete list of such stockholders, that they are the owners of the entire issue of the stock of said company, and that the signatures to said waiver are genuine and in the proper handwriting of the subscribers.

Alfred Day
Secretary.

Sworn to and subscribed before me, this 16th day of February, A. D., 1939.

Jane L. Sheldon (SEAL)
JANE L. SHELDON
1000 Packard Bldg.
NOTARY PUBLIC
My Commission Expires March 2, 1941.

JUDGES' RETURN

We, the undersigned judges, appointed by the Board of Directors of J. Robert Bazley, Inc., to conduct an election by the stockholders thereof, for or against an increase of the formal corporate indebtedness of the company from nothing to $400,000.00, do hereby certify that we held the election on the 16th day of February, 1939, at the office of said company, the time and place fixed for holding the same, of which sixty days' previous notice by publication was duly waived, and in due form and manner we received the votes of the stockholders of the said company in favor of or against such increase; and at the said election there were

voted in favor of such increase 1,000 shares and against such increase no shares, thereupon evidencing the consent of the persons holding the larger amount in value of the capital stock of said company to the said increase.

Charles J. Schuster
Russell L. Hershberger
Richard W. Evans

JUDGES' RETURN

We, the undersigned judges, appointed by the Board of Directors of J. Robert Bazley, Inc., to conduct an election by the stockholders thereof, for or against an increase of the capital stock of the company from 1,000 shares of the par value of $100.00 per share to 5,000 shares without nominal or par value, the stated capital applicable to said non-par value shares to be $300,000.00, do hereby certify that we held the election on the 16th day of February, 1939, at the office of said company, the time and placed fixed for holding the same, of which sixty days' previous notice by publication was duly waived, and in due form and manner we received the votes of the stockholders of the said company in favor of or against such amendment; and at the said election there were voted in favor of such amendment 1,000 shares and against such amendment no shares, thereupon evidencing the consent of the persons holding the larger amount in value of the capital stock of said company to the said amendment.

Charles J. Schuster
Russell L. Hershberger
Richard W. Evans

UNITED STATES OF AMERICA
COMMONWEALTH OF PENNSYLVANIA

J. Robert Wazley, Inc.

Twenty Year Six Per Cent. Debenture

Due February 1st, 1959

Authorized Issue, $400,000.00

J. Robert Wazley, Inc., *a corporation duly organized and existing under the laws of the Commonwealth of Pennsylvania (hereinafter called the "Corporation"), for value received, hereby promises to pay to the registered holder hereof, on the first day of February, 1959,*

.....Dollars ($.....),

in coin or currency which at the time of payment is, under the laws of the United States of America, legal tender for public and private debts, at the office of the Corporation at Port Carbon, Pennsylvania, and to pay interest on said sum from February 1st, 1939, in like coin or currency, at said office, at the rate of six per cent. per annum on April 30th in each year until maturity, without deduction therefrom for any taxes assessed against the holders of said debentures by reason of their ownership thereof as provided by the laws of the Commonwealth of Pennsylvania (other than income, succession, estate, and inheritance tax laws), and the corporation agrees to pay such taxes, not exceeding, however, eight mills per annum on each dollar of the principal amount hereof. This debenture is one of a duly authorized issue of debentures of the Corporation aggregating the principal amount of $400,000.00, all of said debentures being of like tenor, date, and effect.

All said debenture bonds are subject to redemption, as a whole or in part, on any interest paying date prior to maturity, upon the payment of the principal sum thereof and accrued interest, at the election of the Corporation, its successors or assigns, by giving thirty days' written notice of its election to redeem to the registered holders thereof.

If the debentures are called for redemption and payment duly provided, the debentures shall cease to bear interest from and after the date fixed for such redemption.

interest from and after the date fixed for such redemption.

The debentures are issuable in denominations of $100.00 or any multiple of $100.00.

This debenture is a fully registered debenture and is transferable by the registered holder hereof in person or by the duly authorized attorney or representative of such holder on the registration books to be kept for the purpose at the principal office of the Corporation, upon surrender of this debenture accompanied by a written instrument of transfer in form approved by the Corporation, duly executed by the registered holder in person or by such attorney or representative, and such transfer noted hereon, or upon cancellation hereof one or more new fully registered debentures of the same aggregate principal amount will be issued to the transferee in exchange therefor. The Corporation may treat the person in whose name this debenture is registered on such books as the absolute owner hereof for the purpose of receiving payment of or on account of the principal hereof and interest due hereon and for all other purposes, and the Corporation shall not be affected by any notice to the contrary.

As a condition precedent to any interchange, exchange, or transfer referred to above, the Corporation may require payment by the holder of a sum sufficient to reimburse it for any stamp tax or any other governmental charge with respect to any transfer involved therein.

No recourse shall be had for the payment of the principal or interest on this debenture, or for any claim based hereon or otherwise in respect hereto against any incorporator or any past, present, or future stockholder, officer, or director of the Corporation, or any successor corporation, all such liability being by the acceptance hereof expressly waived and released.

In Witness Whereof, J. ROBERT BAZLEY, INC., has caused this debenture to be signed by its President and its corporate seal to be hereto affixed and to be attested by its Secretary, this 1st day of February A. D. 1930.

J. Robert Bazley, Inc.

By _____ President

Attest:

Secretary

BROWN-GREEN CO. NEW YORK

© THE BROWN-GREEN CO 48 JOHN ST N Y 14

REGISTRY AND ENDORSEMENT

DATE OF REGISTRY	NAME & ADDRESS OF REGISTERED OWNER	COUNTERSIGNED BY

SPECIMEN
BROWN-BRETT CO
NEW YORK

32a

J. Robert Bazley.
Inc.

6 PER CENT

$_____

TWENTY YEAR

DEBENTURE

PRINCIPAL DUE

February 1st, 1959

INTEREST PAYABLE

Annually on April 30th

EXHIBIT 4-D

J. ROBERT BAZLEY, INC.
SCHEDULE I
COMPARATIVE STATEMENT OF ASSETS AND LIABILITIES
AT APRIL 30, 1939 and APRIL 30, 1938

ASSETS

	April 30, 1939		April 30, 1938	
Current				
Cash		$120,964.87		$154,675.29
Accounts Receivable	270,540.47		269,719.99	
Less				
Reserve for Bad Debts	66,895.24		51,977.35	
		203,645.23		217,742.64
Investments at Cost				
U. S. Securities (Sched. III)	27,268.32		—	
Bonds (Sched. III)	166,010.61		36,614.31	
Stocks (Sched. IV)	83,943.48		54,068.51	
		*277,222.41		*90,682.82

Exhibit 4-D of Stipulation

339

J. Robert Bazley—Personal		—		868.95
Corporate Loans Tax—F. Y. 1936		47.50		—
Total Current Assets		601,880.01		463,969.70
Fixed				
Plant and Equipment	719,782.41		823,498.72	
Less Reserve for Depreciation	375,823.09		387,596.07	
Total Fixed Assets		343,959.32		435,902.65
Compensation Insurance Deposit		3,000.00		3,000.00
Charter Fees		387.50		387.50
Goodwill		10,000.00		10,000.00
Total Assets		959,226.83		913,259.85
LIABILITIES				
Current				
Vouchers Payable		34,596.43		33,163.76
Royalties Payable		—		3,672.00
Accrued Wages		13,246.89		14,137.54
Accrued Compensation Insurance		1,887.74		1,627.69

Exhibit 4-D of Stipulation

Retained Money—Truckers		1,018.06		500.00
Federal Old Age Benefits Tax		715.78		342.14
Unemployment Insurance Tax		1,931.24		1,497.38
Reserve for State and Federal Taxes		36,232.50		22,429.52
Total Current Liabilities		89,728.64		77,370.03
Debenture Bonds Payable		400,000.00		—
Total Liabilities		489,728.64		77,370.03
Deferred Credits		—		569.75
		489,728.64		77,939.78
NET WORTH				
Capital Stock	300,000.00		100,000.00	
Surplus	169,498.19		735,320.07	
		469,498.19		835,320.07
		$959,226.83		$913,259.85

Exhibit 4-D of Stipulation

* Subject to shrinkage in value of investments of $18,615.00 at April 30, 1939 and $25,789.07 at April 30, 1938.

CORRECTED TRANSCRIPT OF PROCEEDINGS.

[57] Court Room No. 2,
Federal Building,
Philadelphia, Pennsylvania,
September 12, 1944—10 A. M.

(Met pursuant to notice.)

Before Honorable Clarence V. Opper, Judge.

Appearances:

Frederick E. S. Morrison, Esq., and Calvin H. Rankin, Esq., 1429 Walnut Street, Philadelphia, Pa., appearing on behalf of Alice H. Bazley and J. Robert Bazley, Petitioners.

W. J. McFarland, Esq. (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing on behalf of the Commissioner of Internal Revenue, Respondent.

[58] PROCEEDINGS.

The Court: Will you call the calendar.

The Clerk: Docket Nos. 1520 and 1521, Alice H. Bazley and J. Robert Bazley.

Mr. Morrison: Ready for the petitioner.

Mr. McFarland: Ready for the respondent.

Mr. Morrison: Frederick E. S. Morrison and Calvin H. Rankin.

Your Honor, I have handed to the Clerk a motion to consolidate these two cases as they involve the same issue.

The Court: Are you Mr. Morrison.

Mr. Morrison: Yes.

The Court: Any objection?

Mr. McFarland: No objection.

THE COURT: Motion will be granted. The cases will be consolidated for hearing and consideration.

OPENING STATEMENT ON BEHALF OF THE PETITIONER.

BY MR. MORRISON.

MR. MORRISON: If Your Honor please, the issue in this case is that the Commissioner has proposed a 90-day letter claiming the existence of deficiencies in tax, income tax, arising out of a transaction which we allege to be a reorganization inasmuch as it was a recapitalization of the corporation known as J. Robert Bazley, Inc., a Pennsylvania corporation.

[59] In 1939, the spring of that year and late winter—that is, I am talking about February and March—the corporation by its directors and stockholders, duly adopted a plan of reorganization by which its then outstanding stock of 1,000 shares of common stock of the par value of $100 each was exchanged for $400,000 face amount of debenture bonds, 6 per cent 20-year debenture bonds, and 5,000 shares of no par value common stock having a stated capital of $300,000. That exchange was made with the stockholders and the old stock cancelled, and thereupon, the capital of the corporation, previously represented by $100,000 of common stock and some $800,000 of surplus, was converted into 300,000 of capital stock, 400,000 of bonds, and I think some 200,000 of surplus.

The Commissioner, in his 90-day notice, in making the determination that these petitioners here had realized a profit or a gain, states, and I quote from the Commissioner's 90-day letter:

> "A. Other income has been increased $80,400, representing the fair market value of bonds of J. Robert Bazley, Inc., received in exchange of common stock of that corporation. It is held that in this transaction you received income of $80,400, which is taxable in your return for the year 1939."

That was so stated in the 90-day letter to Alice [60] H. Bazley, and similarly, it was so stated in the 90-day letter issued to J. Robert Bazley, except that the amount of $80,400 was changed or was made to read $319,200.

Now, it is the contention of the petitioners that this was a tax-free reorganization under Section 112-B (3) and G of the Internal Revenue Code—in fact, I think it was the Revenue Act of 1938 at that time—and that no gain or loss was realized or to be recognized to either one of them.

That is the substance of our position.

THE COURT: Do I understand that as far as the receipt of the common stock is concerned, that there is no controversy?

MR. MORRISON: No controversy whatsoever—at least the Commissioner has never said so. All he says that on the exchange of the bonds for the stock, income arises in the full amount of the fair market value of the bonds, without ascribing—and I want to point that out while you mention it. He fails to do two things. He ascribes no value or no basis to the old stock in computing the portion of the bonds that he alleges to be taxable, and the second thing he does——

THE COURT: Will you state that again, please?

MR. MORRISON: The Commissioner, in his 90-day letter, failed, assuming that there is a taxable transaction on the exchange of bonds for stock, although we do not [61] admit that for one second—he allocates no part of the basis of the stocks given up by the stockholders to those bonds in arriving at the amount of gain realized by these petitioners.

THE COURT: Do you say he should?

MR. MORRISON: Yes, that is, if it is a taxable exchange.

THE COURT: Well, suppose his position is that the stock, that the new stock that was issued to the petitioners is what carries the basis?

Mr. Morrison: I don't see how he can. In his 90-day letter he recognizes an exchange, and he says, "In exchange for the stock you got from the corporation bonds."

Now, he also knows that they got stock from the corporation. That is stipulated. We will offer that in a minute.

Now he says, on that exchange, reading from the 90-day letter—I don't know whether Your Honor wants it taken down:

> "Other income has been increased $319,000, representing the fair market value of bonds of the J. Robert Bazley, Inc., received in exchange of common stock of that corporation."

Now, any taxable exchange requires that the thing given up, the basis of the thing given up, must be applied [63] against the value of the thing received, and gain or loss realized and recognized, but he doesn't say that. He doesn't give us any credit or an allocation of the basis there.

The other thing is this. That he fails to recognize, although the stipulation clearly shows it, that this stock was held for more than 24 months. Therefore, it is not permissible under the law to recognize in the so-called taxable exchange, anything but 50 per cent. of the proper amount of gain, and then to tax that as a maximum of 30 per cent. under the capital gain rate.

The Court: Now, I notice that there is a small item referred to in the deficiency notice. It is unallowable deduction. I take it there is no issue as to that, is that right?

Mr. Morrison: I doubt it. Oh, yes, we are not bothering with that.

The Court: Thank you.

OPENING STATEMENT ON BEHALF OF THE RESPONDENT.

By Mr. McFarland.

Mr. McFarland: If the Court please, these dockets involve deficiencies in income tax liabilities for the year 1939 of J. Robert Bazley and his wife, Alice H. Bazley, in the respective amounts of $214,170.52 and $35,734.49.

The issue in both cases arises by the action taken [63] on the part of the respondent whereby he included in the taxable income of both petitioners for the year 1939 the face value of the bonds of J. Robert Bazley, Inc., received by each petitioner pursuant to the terms of the so-called plan of reorganization.

The respondent contends that the exchange by the petitioners of stock—that is, for stock and debenture bonds pursuant to a plan of reorganization of J. Robert Bazley—and the plan, I believe, bore the date of February 1, 1939—does not come within the applicable provisions of the Internal Revenue Code or the Revenue Act of 1938, which I believe was in effect then, but rather represents a distribution of a dividend to the extent of the accumulated earnings after February 28, 1913.

The plan provided, or rather, the transaction involved 1,000 shares of common stock, having a par value of $100 per share, and they were surrendered by the shareholders who received therefor 5,000 shares of no par common stock plus corporate 20-year 6 per cent. debenture bonds with a face value of $400,000, which increased the corporate indebtedness from nothing to $400,000 thereby.

The respondent contends that the structural change here made does not meet and thus fails to satisfy the requirements of the term "recapitalization" as used in Section 112 (g) (1) (E) of the Code, of the Internal Code, in that it was not motivated by legitimate business purposes [64] and was not necessary to and did not, in fact, strengthen the financial structure of the corporation, and that that which was accomplished was essentially equiva-

ient to the distribution of a taxable dividend by the corporation, and I would like to cite at this time the remarks of the Court, the Tax Court in the case of Arthur J. Hooks and W. J. Norton, Docket 109,416 and 109,427, which was decided on August 22 of this year by the Court, and it is set forth in the body of the Court's opinion.

"There are three tests, namely,

"A. That it be motivated"—that is, the reorganization—"by legitimate business purposes.

"B. That it be necessary to strengthen the financial structure of the corporation, and

"C. That as a result of the recapitalization, the stockholders have substantially the same interest in the corporation as before."

THE COURT: Aren't you allowing yourself to be confused by the position of the petitioner? You keep talking about an exchange here, and Mr. Morrison properly points out that if you exchange something, you have got to take into consideration what you are exchanging.

As I understand your statement now, what you say is, assuming that the common stock was an exchange, that the [65] delivery of the bonds was the distribution, was the equivalent of a dividend, and therefore taxable and not only taxable in full and without any reduction of the basis, but taxable as ordinary income and not as capital gain.

Isn't that your position?

MR. MCFARLAND: That is our position.

THE COURT: Then you don't really mean that those bonds were exchanged for anything?

MR. MCFARLAND: No, we haven't admitted that the bonds were exchanged for anything.

THE COURT: It isn't a question of admitting; you keep talking about an exchange. I just want to be sure that there isn't any misapprehension as to your position.

As I get it now, what you say is that, assuming that there was an exchange of stock for stock, that the addition in that transaction of the bonds was a distribution by the corporation and it was the equivalent of a taxable dividend, is that right?

MR. MCFARLAND: That is our position.

THE COURT: And even though the petitioner may say that the whole thing was an exchange, a taxable exchange, you take the position that as far as the bonds are concerned, there was no exchange at all, is that right?

MR. MCFARLAND: That is correct.

THE COURT: I think it is going to be important [66] for us to try to keep these positions in mind here, not only now, during the hearing, but also, more important, when you come to filing your briefs.

MR. MCFARLAND: Very well.

THE COURT: Do you have something more you wanted to say?

MR. MORRISON: Just this, Your Honor. I don't see how, when this court and the Circuit Court of Appeals and the Supreme Court have said you have got to look at the transaction as a whole, how you can put a knife through and say you are going to recognize this, as an exchange of stock solely for stock. Truly, you had an exchange of stock for stock on the one part, but also an exchange of bonds for stock, because 1,000 shares of stock went back to the corporation, was cancelled, and in exchange for that, out flowed 5,000 shares of common stock and the debenture bonds, all in the same transaction.

THE COURT: You are not suggesting, are you, that a taxpayer could create something which he called a plan of reorganization and, in connection with that, he could make an exchange of two essentially synonymous articles and then, by the distribution either of taxable stocks or bonds

or property or of cash, could so tie up the two things that that distribution would be non-taxable?

MR. MORRISON: Oh, no, because there you have that covered very well by the statute in 112-C as——

[67] THE COURT: Yes, that is the other property provision. But as I understand it, it says the bonds are the equivalent of other property.

MR. MORRISON: Oh, but he can't under that section. He can't say under the section 112 (c) (1) and (2), that the bonds constitute other property.——

THE COURT: Well, you put words in his mouth.

MR. MORRISON (Continuing): —because if he does, he starts off with the premise that there was a reorganization.

THE COURT: But suppose he says to me, "I don't care if there was a reorganization."

MR. MORRISON: Then he has got to take it out of the reorganization provisions, and there is no way that he can do that.

THE COURT: He has already suggested a way.

MR. MORRISON: Not a way in accordance with the statutes, sir.

THE COURT: Of course, this is put on the statute by the decided cases. I am not going to let you come in here and talk about the statute as though Gregory against Helvering had never been defined.

MR. MORRISON: What Gregory and Helvering says is that the transaction grows out from 112-B, and all the cases that have been decided where they have said, "Well, where you have had a reorganization——"

[68] THE COURT (Interposing): Isn't that what the respondent is saying here?

MR. MORRISON: No, as I understand his position he says "the exchange of stocks is all right. We have no quarrel

with that, although the stock was increased from $100,000 of value to $300,000 stated value. I am not quarreling with that. I don't mind that surplus was changed to accomplish that just as it would be accomplished in a stock dividend. What I quarrel with and object to is that the corporation issued these 20-year debenture bonds which I recognize are securities of the corporation."

THE COURT: You are the fellow who says there was a reorganization. Why does the respondent have to take a position on that one way or the other? Suppose he says to me, "I don't care if there was a reorganization or not."

MR. MORRISON: But he didn't say that.

THE COURT: Well, I am not going to hold him to a particular type of language here. He asked me, as I understand his opening statement, to concentrate on these bonds.

MR. MORRISON: That is right.

THE COURT: Now, we are not saying anything about the stock, and I suppose it is possible for him to say, "Maybe the petitioner is getting away with something."

MR. MORRISON: Wait a minute, Your Honor. I don't think that any Court or any member of the Government should ever infer that a taxpayer is getting away with anything. I [69] think it is too serious an implication.

THE COURT: Well, now, you have misunderstood me, because what I meant—and I think if you keep your mind open a minute you will see that is what I meant—was that the respondent was suggesting that perhaps he should have taxed the petitioner on the stock.

MR. MORRISON: I think he should——.

THE COURT: And to that extent the petitioner is getting away with something, but he says, "Even assuming that I did not have to tax that, even assuming that the petitioner is entitled to look on the stock as an exchange on which the tax would be postponed—and I am not taking a position on that one way or the other," says the respondent, "never-

theless, the bonds are a distribution either because there was no reorganization at all—and, of course, in that case, the stock would have been included too—or because, assuming that there was a reorganization as far as the stock is concerned, the bonds are the property.

MR. MORRISON: Yes. But, Your Honor, please, I did not finish what I started to say—If he says the receipt of the bonds constitutes a taxable exchange, he has got to say that the stock constitutes a taxable exchange.

THE COURT: Suppose he says that. You cannot come in here and complain because he is not taxing you, because I [70] don't know what the facts are, the basis is higher than the market value of the stock, but assuming that there was a taxable gain on that exchange, you are in no position to complain because he isn't taxing you on that.

MR. MORRISON: But I have a complaint to make on the rates he applies on even a small part of the gain, so called.

THE COURT: I agree with you, but no complaint with respect to what he doesn't tax.

MR. MORRISON: No. I say this: that if he says that this is a transaction coming under 112-B, as to the stock, it is free, but as to the bonds, it is taxable, he must prove that position and state to you clearly what he means by it because he will find nothing in the statute to support him on that proposition. He has got to take the whole transaction out of 112-B and put it into 112-A, or some other section, but he cannot leave it in 112-B in any part or any degree. That is my position, and I think he should answer you as to just what his position is, because the 90-day letter, the only thing the taxpayers can look to as to why Commissioner has any idea about a thing, says, "We are going to tax you on $80,000 in one case, $319,000 in the other, on the ground that you received income when you received bonds for stock."

Now, that is an inaccurate statement. They could have said, "We are taxing you on the bonds."

[71] THE COURT: Well, the reason I asked Mr. McFarland as specifically as I did for a statement of the position now is precisely what you suggest. I understand he now says, as far as the bonds are concerned, there is not any exchange at all.

MR. MORRISON: All right.

THE COURT: And I think I asked him several times to be absolutely certain.

MR. MORRISON: But I think, in fairness to the petitioners, Your Honor, he should state it more clearly, because I don't think that this Court or the Circuit Court of Appeals or the Supreme Court will allow you to carve a transaction into several parts.

They have said, "No, you start at the beginning and look at the end, and what happens in between is just part and parcel of one whole transaction. We are not going to say that there are two reorganizations or a sale and an exchange."

THE COURT: I think you will find a number of cases—and I wouldn't be able to put my finger on them—but I think you will find there are cases which fail to apply that rule to this particular type of situation, namely, where something has the aspect of a dividend, or where the Commissioner has contended it is a dividend, and I think that that is a situation where they have cut off the exchange and dealt with the [72] other property.

MR. MORRISON: Yes, but I would like the Commissioner to state to you in open court just what sections of law apply to this case, in his judgment, because I think it will clarify the issues and help us and help the Court to understand what the case is all about.

THE COURT: I am not going to ask him to do that, but I will do this. If you get to the point where there is evidence that you propose to submit which you will have to deal with differently, depending on how the Commissioner

takes his position, I will ask him to do that then, but I want to be sure how it makes any difference to you.

MR. MORRISON: Very well, I will appreciate that.

Now, I offer in evidence stipulations of fact entered into by the respondent's counsel and petitioners' counsel.

THE COURT: You will need an original and two copies.

MR. MORRISON: I have given them to her.

THE COURT: The stipulation will be received.

MR. MORRISON: Mr. Bazley, will you take the stand, please?

Whereupon, JAMES ROBERT BAZLEY, called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

[73] DIRECT EXAMINATION.

By MR. MORRISON:

Q. Mr. Bazley, please state your full name.

A. James Robert Bazley.

Q. And what is your occupation?

A. Contracting engineer, president, treasurer of J. Robert Bazley, Inc.

Q. What are your qualifications as contracting engineer? What has been your experience—education and experience?

A. A graduate of mechanical engineering from the University of Michigan. I have had in the mechanical engineering field some 33 years of experience in mining engineering.

Q. Are you a consultant engineer?

A. Yes, sir.

Q. When were you last consulted?

A. During the last seven months I have been consultant for the British Ministry of Works in England, just having returned from there two weeks ago—three weeks ago.

Q. Were you consulted over there on mining engineering problems?

A. Yes, I was asked to go over there to develop a quick coal in the Allied war.

Q. And, you say, by the British Ministry?

A. By the British Ministry of Works, on recommendation from the industry in this country.

[74] Q. What do you mean by "the industry in this country"?

A. The coal industry.

Q. Is your corporation allied with the coal industry?

A. Our corporation removes the overburden from coal, and by a method known as the open pit mining, the coal is recovered 100 per cent by this method. It is a very quick method of obtaining coal, and that was the reason for wanting to develop this quick coal in England for the Allied invasions.

Q. Does your corporation have mines of its own?

A. We have no mines, no.

Q. Well, then, this work that you do for the coal companies—is that under contract?

A. It is all under contract, yes, sir.

Q. Well, discuss briefly, if you will, sir, the business of J. Robert Bazley, Inc.

A. J. Robert Bazley, Inc., is incorporated under the laws of Pennsylvania.

Q. Well, that has all been stipulated. Just tell us about your business.

A. Our charter is rather broad. We have the privilege, the right to any heavy type of excavation, concrete, railroad work, concreting, building railroads.

As I have already said, we mine coal by the open pit method, build highways, a general contracting business, heavy contracting.

[75] Q. Who are the officers of your corporation, please?

A. I am president-treasurer. Mrs. Bazley is vice-president. Mr. Alfred Day is secretary. Mr. Russell Hershberger is assistant treasurer.

Q. Now, Mr. Bazley, we have stipulated—and, by the way, have you read this stipulation?

A. Yes, I have read it.

Q. We have stipulated the facts, or some of the facts pertaining to the issue, namely, reorganization and recapitalization of your company, J. Robert Bazley, Inc., and that briefly shows that your capital structure was, prior to about February 1, 1939, $100,000 of common stock comprising 1,000 shares of a par value of $100 each, and a surplus of $855,000, or a total of $955,000, and that the plan of recapitalization was voted by the directors and stockholders whereby the common was increased from $100,000 to $300,000 stated value, comprising 5,000 shares of no par value, and the indebtedness was increased from nothing to $400,000, and it was upon the consummation of the plan represented by 20-year 6 per cent debenture bonds of that corporation, and that new stock, 5,000 shares of new common and the $400,000 face amount of new bonds, was issued by the corporation in exchange for the outstanding shares of stock—that is, comprising 1,000 shares of $100 each, and the stockholders turned in their old stock, and that was retired and received in exchange for the new stock [76] and the new bonds.

Q. Now, tell the Court please, what prompted the directors and the stockholders to propose and vote for this plan of reorganization.

A. Well, the management—that is, the officers and superintendent and assistant treasurer, in the discussion felt that it was advisable—or at least it seemed advisable—to try to sell stock to the key employees—that is, superintendents, engineers and foremen, and we stated a plan that would be adaptable, would be suitable for this purpose. And it seemed for that purpose, for the purpose of selling stock to the officers and superintendents and other key men, in order that they might have a financial stake in the company, that it would be advisable to reduce the value of the stock in some way so as to increase their share in the company at the time that this plan went into effect, so we hit upon this plan of stock and debenture bonds.

MR. MCFARLAND: If the Court please, Mr. Bazley, what are you testifying from?

THE WITNESS: I have my notes.

MR. MCFARLAND: Notes that you have made? Have you made them yourself or in connection with your attorney?

THE WITNESS: No, sir, by myself.

MR. MCFARLAND: Before you spoke to your attorney about it?

[77] THE WITNESS: Absolutely.

By MR. MORRISON:

Q. Go right ahead, Mr. Bazley.

A. Furthermore, it seemed to us in conference with this management, that this plan of issuing common stock and debentures would also secure for the corporation certain benefits inasmuch as the fixed charges on the bonds would have the purpose of reducing Federal and State taxes, and it would also enlarge the percentage of dividends on the reduced value of the stock inasmuch as the value of the stock had been reduced.

Further, it would give the shareholders a security in the form of a bond which is very much less fluctuating, more readily marketable, particularly where, in the case of deceased stockholders, the bonds could be liquidated for inheritance taxes or other purposes; if it would be necessary or possible, without reducing the family management. You could still keep the Bazley management in control.

Furthermore, at the time that this reorganization was considered, the work we were doing was practically 100 per cent stripping work, mining of coal by the open pit method.

The coal business was very poor. It was almost impossible to get contracts that were profitable at that time; and we considered or were considering very seriously going into road building. Road building work is a very hazardous [78] job. Many contractors have gone into it and failed. It seemed to me that at this time, if we were going into this business, that these bonds would give to the shareholders

an obligation which, in the event of reverses in this new enterprise, would at least put them in a position to share alike with any creditor.

Q. Were there any other reasons?

A. Yes, at this same time the fixed assets of the corporation were very large in relation to the amount of stock outstanding—that is, to the face value of the stock, due to the fact that there had been an accumulation of profits that had all been turned back into the business, new equipment purchased.

We might add that the equipment used in this particular type of work is very expensive and requires a great deal of working capital. Recently, within the last two years I purchased a machine which cost approximately $200,000, and I have another one coming this fall that will cost in the neighborhood of the $200,000. As a matter of fact, this work, in order to start what I call a proper contract, sometimes demands as much as $500,000 ready cash.

I know one case required three-quarters of a million, so these fixed assets were here and had been built through accumulation, and it seemed very advisable to reflect this accumulation of earnings in the permanent dedication of these [79] funds and put it into corporation use.

Q. Now, have you any other reason, Mr. Bazley?

A. Well, those were the major reasons.

Q. Have you had any experience in banking or in connection with any banks?

A. I am vice-president of the Miners' National Bank of Pottsville, Pennsylvania, which is the largest bank in Schuylkill County.

Q. Are you a director of that organization?

A. Yes, sir.

Q. You are?

A. Yes, sir.

MR. MORRISON: Cross-examine.

CROSS-EXAMINATION.

By MR. MCFARLAND:

Q. Mr. Bazley, can you give us the names of two or three specific road building jobs that your company has performed in times past?

A. I completed the Mt. Hope job just outside of Reading, took that over from the contractor, the bonding company.

Q. When was that you are speaking of, Mr. Bazley, what year?

A. I think it was in 1940, late 1939.

Q. And when you say you completed it, what do you mean, you completed it?

[80] A. Completed it to the satisfaction of the bonding company.

Q. What did you do?

A. Built the road.

Q. Built it?

A. Completed it.

Q. You took it over from the bonding company?

A. Yes.

Q. That is near Reading, you say?

A. Five miles south of Reading.

Q. How large a contract was that?

A. I think it was something like 300,000. That is my recollection. Then we next built the 4-lane highway from St. Clair, Pennsylvania, up to Frackville.

Q. In what year was that?

A. 1940, I think. Also, South Tamaqua, 4 or 5 miles into Lehigh in that year, and recently completed 5 miles of triple and 4-lane highway. We call it the Deer Lake Highway which goes south to Orwigsburg to South Clinton.

Q. These are all in Pennsylvania?

A. Yes, sir.

Q. In what year did that latter construction take place?

A. In 1941 and 1942.

Q. 1941 and 1942? What road construction prior to 1940 [81] has your company been engaged in?

A. We had no direct contracts. We were sub-contracting, doing some of the excavating work for other contractors.

Q. Can you give me an idea as to the nature of those contracts and the locality of the work done and the years in which it was done?

A. I think New Hope, Pennsylvania, in 1938, and up in Lehigh County in the Poconos in 1939, an excavation job which we contracted. C. L. Miller was the contractor.

Q. When you say that your Company also engages in general contracting, beyond the road construction that you have just enumerated, do you do other contracting in addition to your open pit mining methods?

A. We do a great deal of miscellaneous work, heavy erection, heavy foundation, steel erection, and that sort of thing.

Q. Give me an idea of the jobs you have done in that connection from the years 1937 on up?

A. I think we moved a large steel structure from Gilberton and Colliery to some place near Tamaqua.

Q. What year was that, Mr. Bazley?

A. I cannot recall. I think it was in 1937 or 1938. We are constantly doing work of that kind. It is pretty hard for me to give a specific date.

Q. In other words, year in and year out you are doing [82] work along those lines, as well as your road construction and your open pit operations?

A. Yes, sir.

Q. Now, the open pit operations—just what does that consist of? I am not a miner, Mr. Bazley, so I don't know what it is.

A. Well, when the coal is near the surface, 7 or 8 feet below the surface to as much as 250 feet, we remove the surface and gain the coal that is underneath by stripping the top surface and mining the coal with some shovels, or

power shovels, rather, and sending the same to the colliery, or wherever the contractors made them.

Q. Ofttime, do you know how many employees in your organization you would classify as "key employees"?

A. I would say about 20.

Q. About 20?

A. 20 to 25.

Q. Out of a general total or average number of employees of about how many?

A. About 350 to 400.

Q. And has that figure been constant within the last 4 or 5 or 6 or 7 years?

A. I think it has been fairly constant.

Q. These key employees—in what capacity are they employed by the corporation?

[83] A. Engineers, superintendents and foremen and assistant foremen.

Q. Did the corporation ever sell any stock to any of them at any time?

A. Not up to the present time, no.

Q. Can you tell me just what specific advantage was gained by the corporation by the issuance of these bonds?

A. Well, I have already given you that.

Q. In general terms, but I would like to have it more specific, if you can.

A. Well, it seemed to me that it gave the corporation a better stock position, particularly to employees, inasmuch as the value of the stock would be lower and you wouldn't have to ask the employees to pay such a large price for stock as you would if you had a big accumulated surplus.

Q. How much of your earnings did you dedicate to the stock?

A. There was 300,000.

Q. You already had one you dedicated?

A. Yes.

Q. The corporation agreed to an obligation of how much by the issuance of these bonds?

A. $400,000.

MR. MCFARLAND: I believe that is all.

[84] RE-DIRECT EXAMINATION.

By MR. MORRISON:

Q. Mr. Bazley, you were asked by Mr. McFarland as to whether or not any stock had been sold to any of the key employees, and you answered that it hadn't. Were there any reasons why that stock hadn't been sold?

A. Yes, there were very good reasons.

Q. Well, first let me ask you this. Did you and Mrs. Bazley intend to sell part of your holdings to your key employees?

A. That is correct, yes.

Q. Why was that not done?

A. Well, shortly after this recapitalization was made, the business went into very much of a slump, and I personally advised the management that it was not a good time—at least, I did not feel morally that it was right to try and sell a stock which at the time, at least, did not have a good future.

Q. Do you recall, just in round figures, if you do recall at all, what earnings you had in the year following the reorganization—that is, the first fiscal year for the first full year after this recapitalization? What were your earnings? Do you recall?

A. $1,528 for the first year for the recapitalization.

Q. And what had they been, just the fiscal year ending [85] at the time of the recapitalization?

A. $104,000.

Q. Well, go on and tell us why you did not sell any stock.

A. Well, in that year, as I said, I had been in Europe that summer and expected to put this through in the fall, and when I got back I found the whole situation, in general, was very bad, and new contracts were very difficult to get, and the earnings were decidedly off, and I thought it was

not the proper thing to offer the employees stock at that time.

Q. What was the condition in Europe when you left in the summer of 1939?

A. Well, the war was on. I was there three weeks after the war started. I was in Germany when they marched into Poland, and went from there to Switzerland and managed to get home through France.

Q. Were there any other reasons why you did not feel it was proper to sell stock of J. Robert Bazley to your key employees?

A. Well, as I have already said, in the next year, in 1941, the depression in the coal business still existed, but there was decided war talk in the air. The Government was at that time making a decided effort to sell Defense Bonds. As a matter of fact, I was very much in the fore in Schuylkill County in selling them myself, and I did not feel it was a [86] proper time to take the earnings from the employees to defeat the purpose of the Government in buying Defense Bonds.

Q. Well, since that time, has any stock been sold by you or the other stockholders to the key employees?

A. No.

Q. And why not?

A. In 1941, as we all know, we had Pearl Harbor in the fall, and the bond drives were increased in tempo. As a matter of fact, I was county chairman of the Third and Fourth War Loan drives and succeeded in putting Schuylkill County in 11th place in the Fourth War Loan drive. I did not feel definitely that it was the time to offer employees stock, and I know very little of it has been done during this war effort.

Q. Do you and the other stockholders propose or contemplate selling any of this stock until after the war is over?

A. No, sir.

Q. Mr. Bazley, tell us this. You spoke of these key employees, some 20, or whatever it was. What is their average compensation from J. Robert Bazley, Inc.?

A. I would say they average around $4,000 to $4,500 a month, some as high as——

Q. Wait a minute! You say per month?

A. Per year. I beg your pardon.

Q. I was going to say, I would take a job myself. [87] Well, what is the minimum and what is the maximum?

A. The minimum is about $2,800 and the maximum is about $6,000.

Q. Do you know, of your own knowledge, whether these key employees are people of means?

A. They are not people of means. I know that definitely they would have to take their earnings to invest in the company, if anything.

Q. This is a sort of supposititious question. When and if the war is over, is it contemplated by you and the stockholders to sell them to the employees, the key employees?

A. Yes, sir.

Q. Will that depend on whether conditions are good or whether they are bad?

A. I will definitely want conditions to be favorable towards the stock before I would sell it to the employees. I feel a moral responsibility in that regard.

Q. At the time you were contemplating effecting this plan of reorganization, did you feel that by selling this stock to your key employees, that they would have a greater interest in the business of the J. Robert Bazley, Inc.?

A. I felt that they should, yes.

Q. Did you feel that they would?

A. I definitely did, yes.

Q. Mr. Bazley, you spoke of an indebtedness or some [88] contract that might go bad on you, or something like that. Did that ultimately work out satisfactorily or unsatisfactorily?

A. Yes. Is it necessary to mention names? Do you wish them?

THE COURT: That is up to you.

By Mr. Morrison:

Q. If you can, mention the names.

Mr. McFarland: What year have you reference to?

Mr. Morrison: The question you asked him about certain indebtedness going bad.

Mr. McFarland: I did not ask him about indebtedness.

Mr. Morrison: In the cross-examination he mentioned about——

Mr. McFarland: I object, if the Court please. It is not a proper re-direct examination.

Mr. Morrison: I beg your pardon. Strike that all out, please.

That is all, Mr. Bazley.

Re-Cross-Examination.

By Mr. McFarland:

Q. Mr. Bazley, I just have a few questions to ask you. Subsequent to the plan of 1939, I believe you testified that the affairs of the company, or the company did not fare too well immediately after the reorganization, as you said.

[89] A. Yes.

Q. Did your employees retain the same rate of compensation through all the period that you have reference to?

A. I am very glad to say that they did.

Q. They did. Did you ever discuss with any of the employees, other than the board of directors, the proposition of offering stock to the key employees at any time?

A. Yes, I have.

Q. When did you do this?

A. Prior to the reorganization and since. I have talked to them and saying that I would like to do it but I did not think the time was advantageous. They know that I am contemplating it, in other words.

Q. The corporation, in other words, never offered the stock to the employees at any time?

A. No.

Q. I hand you the corporate return of J. Robert Bazley, Inc., and ask you if your signature appears on that.

MR. MORRISON: May I see that, because often we have papers in here that don't belong in them.

(Mr. Morrison has several papers from the corporate return removed.)

By MR. MCFARLAND:

Q. The corporation is on a fiscal year basis?

A. Correct.

[90] Q. Fiscal April 30th?

A. That is right.

Q. Directing your attention to the corporate return filed on behalf of J. Robert Bazley, Inc., fiscal year May 1, 1939, and ending April 30, 1940, does your name appear on the face of the return?

A. Yes, sir.

Q. That is the return of the J. Robert Bazley, Inc., as filed?

A. Yes.

Q. Can you indicate from that return the net income for that year?

MR. MORRISON: Wait a minute. I object to that.

THE WITNESS: It is partly there. Part of it has been removed.

MR. MORRISON: If Your Honor please, I want the question rephrased. I want him to talk about actual net income.

By MR. MCFARLAND:

Q. Well, can you indicate to me the adjustable net income?

MR. MORRISON: You mean subject to tax?

MR. MCFARLAND: That is correct.

By Mr. McFarland:

Q. What is that figure?

[91] A. $2,257.51.

Q. Referring to the return for the fiscal year of May 1, 1940-April 30, 1941, of J. Robert Bazley, Inc., what is the adjusted, normal tax net income for that year disclosed by the return?

A. Normal tax net income, $50,676.31.

Q. Referring to the corporate return for the fiscal year May 1, 1941, to April 30, 1942. Can you tell me the normal tax net income reported for that year?

A. Normal tax net income, $58,658.95.

Q. By the way, Mr. Bazley, what was the addition disclosed on your balance sheet to surplus in that year? Your beginning surplus was what figure?

A. The earned surplus and undivided profits?

Q. That is correct.

A. $203,907.

Q. And at the end of the year?

A. $234,697.

Q. Do you recall off-hand, Mr. Bazley, what the net income of the corporation was for the fiscal year ending April 30, 1943?

Mr. Morrison: Do you mean the taxable net income?

Mr. McFarland: Taxable net income, yes.

The Witness: No, I don't.

Mr. McFarland: That is all. No further questions.

[92] Further Re-Direct Examination.

By Mr. Morrison:

Q. Mr. Bazley, you were just a moment ago stating there the taxable earnings and the surplus of the company. Did your corporation pay any dividends in the years immediately following the recapitalization? Did your corpora-

tion pay any dividends immediately following the recapitalization?

A. Yes, sir.

Q. Did it pay any dividends for years preceding the recapitalization, say five years preceding the recapitalization?

A. Yes, sir.

Q. Do you know the percentage of your earnings that were distributed as dividends? Do you know the percentage of your earnings that were distributed as dividends before the recapitalization and after?

MR. MCFARLAND: I object to this line of questioning. I think the best evidence are the books of the corporation. If Mr. Bazley will testify as to where he derives his information and the amount of payments, all right.

THE COURT: If this witness knows, the books are only evidence of what the facts are. If he knows the facts, let him do it. He is asked for his knowledge. If he doesn't know, that is something else.

By MR. MORRISON:

[93] Q. I am asking for his knowledge. Do you know?

A. They approximated it by 37 per cent.

Q. When?

A. In the years 1935, 1936, 1937 and 1938.

Q. How much did they approximate in the five years immediately following the reorganization, up to April 30, 1943?

A. About 56 per cent. or 57 per cent.

Q. In other words, you say that the corporation, in the five years preceding, distributed 38 per cent. of its earnings in the form of dividends to the stockholders. Were they cash dividends?

A. Yes, cash dividends.

Q. And that immediately after the recapitalization, that which the corporation distributed was what percentage?

A. 56 per cent. 56 or 57 per cent. It is about that.

MR. MORRISON: That is all. That is all, Mr. Bazley.

MR. MCFARLAND: Just a moment. I may have another question.

FURTHER RE-CROSS-EXAMINATION.

By MR. MCFARLAND:

Q. Mr. Bazley, directing your attention to the schedule M as appears on the income tax return of the corporation for the fiscal year May 1, 1940, April 30, 1940—1941, total distributions to stockholders in that year were $25,000, is [94] that correct?

A. That is correct.

Q. And the common stock carried on the corporation's capital stock account was $300,000?

A. Correct.

Q. What percentage is 25 in that case?

MR. MORRISON: Wait. Percentage of what?

MR. MCFARLAND: Percentage as bears relation to the 300,000.

MR. MORRISON: He wasn't asked anything about the percentage on that. He was asked about the percentage of earnings.

MR. MCFARLAND: I am asking him the question. I am not asking him what was asked.

THE WITNESS: About 8½ per cent., about 8½ per cent. A little over 8½ per cent.

By MR. MCFARLAND:

Q. For the year May 1, 1941 to April 30, 1942, did the company distribute the dividend in that year to its common stockholders?

A. That was what year? Ending when?

Q. Ending April 30, 1942.

A. Yes.

Q. How much?

A. $15,000.

[95] Q. And the capital stock and common stock was still 300,000?

A. $300,000.

MR. MCFARLAND: That is all of this witness.

MR. MORRISON: Just a minute, please.

FURTHER RE-DIRECT EXAMINATION.

By MR. MORRISON:

Q. Mr. Bazley, I show you your corporation's income and excess profits tax return for the fiscal year beginning May 1, 1938, and ending April 30, 1939, which shows on Schedule P—first of all, is that your signature on that return?

A. Yes, sir.

Q. It shows on Schedule P, total distributions to stockholders, charged earned surplus during the taxable year in what amount?

A. $70,000.

Q. Do you recall whether that distribution was made immedately after or prior to the recapitalization?

A. It was made immediately after.

MR. MORRISON: That is all.

MR. MCFARLAND: On what date, if you recall?

THE WITNESS: Well, it was made during that fiscal year.

MR. MORRISON: Yes, but you say immediately after.

[96] Now, what month was it?

THE WITNESS: Well, it was up to——

MR. MORRISON: No, what month did you make the distribution?

THE WITNESS: I am not sure exactly what date.

MR. MORRISON: But what month? You say it was after the recapitalization. What month was it?

THE WITNESS: I think it was March or April.

MR. MORRISON: After recapitalization?

THE WITNESS: Yes.

MR. MCFARLAND: What event associates itself in your mind to say it was either March or April?

THE WITNESS: Because that was usually the time we consider dividends.

MR. MCFARLAND: In other words, you have no specific knowledge other than what you normally do?

THE WITNESS: That is right. I am quite confident that is why.

MR. MCFARLAND: Do you know.

THE WITNESS: No, I don't know definitely.

MR. MCFARLAND: Very well. That is all.

MR. MORRISON: That is all.

THE COURT: Mr. Bazley, just a moment, please.

THE WITNESS: Yes.

THE COURT: Do you happen to have—I notice that [97] you referred to the earnings of the year, as I recall it, just before the recapitalization. Was that around $100,000, did you say?

THE WITNESS: Before the recapitalization.

THE COURT: A year before it?

THE WITNESS: The year before it was $65,000.

THE COURT: And didn't you mention the figure of $104,000?

THE WITNESS: As the year of the capitalization, yes. In other words, that year ended about two months after the recapitalization, three months after the recapitalization.

THE COURT: And that was the most profitable year, or one of the most profitable years that you had, is that right?

THE WITNESS: Up to that time, yes.

THE COURT: So that there were what, two or three months between the recapitalization and the end of that year?

THE WITNESS: Yes.

THE COURT: Did you make it clear why it was you did not take up advantage of that two or three months period to dispose of this stock as you say you planned to?

THE WITNESS: Well, I did not definitely know what the earnings would be until after the end of the year, and then, as I say, my contracts were expiring with the various coal companies, and the outlook at that time was very poor.

[98] THE COURT: Well, didn't you know before recapitalization that those contracts were going to expire?

THE WITNESS: Yes, but I did not know definitely that the output was going to be as bad because March and April are always the worst months in the coal business. At that time this bootleg business was extremely bad in Pennsylvania and we had the worst outlook for coal for some time, particularly for stripping work.

THE COURT: For how long?

THE WITNESS: Well, I would say ten years.

THE COURT: Had the business been fairly stable during the ten years before that, or, by business, I mean, had the profits been roughly about the same?

THE WITNESS: No, they were up and down, I would say.

THE COURT: The coal business is up and down?

THE WITNESS: That is correct.

THE COURT: You knew that before you ever planned this distribution, didn't you?

THE WITNESS: That is right.

THE COURT: Would one bad year put you in a frame of mind where you thought you shouldn't carry on this plant?

THE WITNESS: Frankly, I had no confidence in the future of the coal business along about late 1939 and 1940. Very lately, the war has brought it back.

THE COURT: Do you want to say something?

[99] MR. MORRISON: Yes, I do, Your Honor, because if you are going to question him along those lines, I want to ask him what the earnings were after the recapitalization.

THE COURT: I think it has already been given, but I will be glad to have you put those in.

MR. MORRISON: I don't recall that you had.

THE COURT: One year, as I recall it, they were 54,000.

MR. MORRISON: That was taxable income.

THE COURT: Well——

MR. MORRISON: It could be $9,000 or $10,000 less than that.

THE COURT: Well, if you are going to draw distinction of importance between taxable income and distributable income, why, I would be glad to have those figures go in, because otherwise it leaves the record in a very unsatisfactory position.

MR. MORRISON: Off the record.

THE COURT: I would rather not have it off the record.

MR. MORRISON: The earnings after April 30, 1939, were not as good as they were before.

THE COURT: How do you mean, not as good? Do you know they compare?

MR. MORRISON: Yes, I do.

[100] THE COURT: How?

MR. MORRISON: For the five years, for the five full fiscal years prior to recapitalization, that is, up to April 30, 1938, from the figures that I have jotted down here from the accountant's certified report, they had $394,000 of earnings.

THE COURT: That is for the five years, total?

MR. MORRISON: That is for the five years preceding, yes. There was one year of loss back in 1935.

Now, in 1939, right after the period of recapitalization, recapitalization became complete in March, and this is for the year ending April 30, 1939, the end of the next month. It was $104,000.

THE COURT: That is for one year.

MR. MORRISON: Yes. That is just in the short period, that is, for that full twelve months, but the results were not known until April 30, 1939.

Now, the next fiscal year it only amounted to $1500.

THE COURT: That was the one Mr. Bazley testified made him change his mind.

MR. MORRISON: In the year following that, 45,000, and in the year following that, which is April 30, 1943—and we were very much in the war then and a great demand for coal existed—it was 140,000.

[101] THE COURT: How does that first five years average, for which you gave me a total?

MR. MORRISON: It was—it would average approximately $80,000 a year.

THE COURT: You deduct $24,000 from that and what do you get?

MR. MORRISON: Well, that is previously deducted. Well, I see what you mean. You mean on the bond.

THE COURT: Yes.

MR. MORRISON: But you are still better off.

THE COURT: What do you get?

MR. MORRISON: You get 370—oh, $24,000 a year. 120? You get $274,000.

THE COURT: Well, I asked you for an average. I think perhaps it wasn't a little bit high. You said five years.

MR. MORRISON: Five years. $394,000.

THE COURT: 394? I thought you said 314.

MR. MORRISON: 394, and you get an average of about 80.

THE COURT: And if you deduct 24,000 from the 80,000, that will give you the average to compare with the subsequent point.

MR. MORRISON: That is correct.

THE COURT: What will that be, about? What would [102] 24 from 80 come to?

MR. MORRISON: 56,000.

THE COURT: 56,000 is just about the average of the post-reorganization years, isn't it, if you leave out that one $15000 year?

MR. MORRISON: No, it isn't, because you have ascribed immediately after the reorganization that full 12-month period. That technically belongs in the prior period. In other words, as of March, 1939, in that year—ten months or eleven months of that year had gone by before the bonds were issued, and that was one of the best years that they had.

THE COURT: Leaving out the $1500 year——

MR. MORRISON: Call it zero?

THE COURT: Because I understand that that is a pivotal year in this discussion.

Mr. Morrison: That is right.

The Court: I understood Mr. Bazley to say that that was such a bad year that it was the reason he did not go ahead with his plans.

Leaving that year out, how did the earnings run?

Mr. Morrison: Well you have got to put your average in. To get your proper average you have to put it in there, or let us make it zero.

The Court: If you put that in and put the $140,000 year, what is your average?

[103] Mr. Morrison: That doesn't make the proper average. For a period of time you are working on a different proposition. Ten months of the year's earnings were earned.

The Court: You misunderstand me. I am talking about 1943. What were the earnings of 1943?

Mr. Morrison: $140,000

The Court: If you put that in and put the zero year in, what average do you get?

Mr. Morrison: Approximately 60,000.

The Court: That is not very different from the 56,000 of the previous years.

Mr. Morrison: No.

The Court: In fact, it is better, if anything, because you are putting in the year 1939 without ten months.

Mr. Morrison: That already expired before the reorganization.

The Court: I did not ask you to put in 1939.

Mr. Morrison: Well, then, if you did not, let us take it out.

The Court: I asked you for the figures.

MR. MORRISON: Well, then I will give it to you right now. The average there will be $57,000.

THE COURT: Just about the same as the pre-reorganization year; is that right?

MR. MORRISON: That is right.

[104] THE COURT: So you cannot say that there was very much change in the business from an over-all standpoint for the whole ten years.

MR. MORRISON: After 1939 you come through 1940, 1941 and 1942 and 1943 and you start to make money.

THE COURT: Isn't that the history of the coal business? If you go back, $104,000 was the profit in 1939, which was not a war year, was it?

MR. MORRISON: Yes, but let me mention 1934, 1935, 1936, 1937 and 1938, and you will get the picture. In 1934, $125,000; 1935, a loss, $4,800, although they paid tax on taxable income, for some reason. The actual result was a loss of $4,800.

THE COURT: Let me interrupt you, Mr. Morrison. It occurs to me that if our discussion here is germane—and, if it isn't, I am just as much at fault as you are. If it is, these figures will not be in the record, because I cannot take the statement of counsel as facts. In other words, I am just pointing out to you so if you think it is material to your case to have them in—maybe you can arrange to have them stipulated with Mr. McFarland.

MR. MORRISON: I can get them in five minutes with another witness.

THE COURT: If we are not talking about materiality, [105] we should get them in.

MR. MORRISON: That is all.

FURTHER RE-CROSS-EXAMINATION.

By MR. MCFARLAND:

Q. One more question, Mr. Bazley. Referring to this compensation of the employees immediately after and at approximately the same time that this February 1, 1939, plan of reorganization was entered into, you referred to the fact that the employees were able to maintain their level of compensation through the lean and flush period, is that right?

A. That is correct.

Q. Did it occur to you that you would probably get an added incentive to the employees if you did offer them stock on a reduced basis on what you determined to be the value of that stock so they could realize it in later years?

A. I had expected to do that.

Q. You did not do it right up to the present?

A. As I previously stated, I did not feel the time was opportune.

Q. And you haven't done it up to the present time?

A. No.

MR. MCFARLAND: That is all.

FURTHER RE-DIRECT EXAMINATION.

By MR. MORRISON:

Q. Mr. Bazley, just a minute. Do you know, of your own [106] knowledge, whether your employees were buying War Bonds and Defense Bonds in that period that the Government was issuing them?

A. My employees are buying their quota of Defense Bonds, I am very glad to say.

Q. Have you personally urged that to be done?

A. Yes.

Q. Including the key employees?

A. Absolutely.

MR. MORRISON: That is all.

THE COURT: Take a ten-minute recess.

(Whereupon, a ten-minute recess was taken.)

MR. MORRISON: If Your Honor please, with regard to the earnings and dividends, there are two ways we can obviously do it. One is to stipulate them. The other is to call a witness. I will do whatever you wish in the matter. It might save a little of your time, that is all.

THE COURT: I would prefer a stipulation, if that is possible. Then I would be sure that there isn't any possible dispute about it.

MR. MORRISON: Thank you. It will only take about a minute or two.

THE COURT: Now, Mr. Morrison, let me ask you this.

You have other witnesses, have you?

MR. MORRISON: I have the certified accountant who [107] keeps the books of the corporation regularly, and he makes up their tax returns and just looks after and does all their bookkeeping, and I was going to call him.

THE COURT: You are going to call him in any way.

MR. MORRISON: No, for two purposes. One, to give the earnings and dividends in the five years before the reorganization, five years after, and the dividend record, and the additions to plant, or fixed assets. That is my case there.

THE COURT: And that is all the testimony you were going to put in?

MR. MORRISON: Yes.

THE COURT: So the question is whether you should call him, or stipulate.

MR. MORRISON: Get these gentlemen to agree to stipulate it. They can't from their figures stipulate the additions to plant. We can show clearly what the

additions to plant were. The Government can do it from their returns, but it will take quite some time, whereas this accountant knows of his own knowledge. He supervised the work done by his men.

THE COURT: I am trying to save as much time as possible. I was thinking of this possibility: That you put the accountant on for whatever it is you think we have to do anyway. Then we can take a recess until after lunch, and I [108] will give you time to work out a written stipulation, and we can reconvene and have you put that in.

MR. MORRISON: I had hoped to finish everything by a quarter of twelve.

THE COURT: I know you had, but I was wondering how long we would have to delay here for this stipulation.

MR. MORRISON: Are you ready?

MR. MCFARLAND: Yes.

(Discussion off the record.)

MR. MORRISON: If the Court please, counsel for the respective parties will stipulate the earnings and the dividends for the five fiscal years preceding the date, the plan of recapitalization— I beg your pardon. He doesn't agree to that.

The date, the agreement, the steps under the agreement were finally consummated. I will first give a list of the earnings, and they are as follows:

For the fiscal year ending April 30, 1934, $117,908—is it agreeable to you to leave off the pennies?

MR. MCFARLAND: Yes.

MR. MORRISON: $117,908; 1935—you might say fiscal year 1935—loss, $4,828; 1936, $106,891; 1937, $96,894; 1938, $65,717.

Now, all of those years or those amounts reflect profits of those years except the year 1935 when a loss, as [109] stated above, was incurred.

The dividends in that period were as follows:

1934, none; 1935, none; 1936, $10,000; 1937, $75,000; 1938, $65,000.

Now, the earnings and dividends for the fiscal years thereafter—that is, from April 30, 1939 to April 30, 1943, were as follows: 1939, $104,178; 1940, $1,528; 1941, $45,015; 1942, $43,884; 1943, $140,549.

The dividend record in that period was as follows—these are all cash dividends. All the dividends I mention are cash dividends:

In 1939, $70,000; 1940, $10,000; 1941, $25,000; 1942, $15,000; 1943, $70,000.

Do you want 1944? That is five full fiscal years before, and those after.

Now, the earnings and dividends for the fiscal year ending April 30, 1944, which just closed. The earnings were $102,890, and the dividend was $70,000.

Mr. Lefferts, will you take the stand?

Whereupon, WILLIAM REUBIN LEFFERTS, called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

[110] DIRECT EXAMINATION.

By MR. MORRISON:

Q. Mr. Lefferts, please state your full name and address.

A. William Reubin Lefferts. Do you want the address?

Q. Yes.

A. Business address?

Q. Business address.

A. Lincoln Liberty Building, Philadelphia.

Q. What is your business, Mr. Lefferts?

A. Certified public accountant.

Q. Of what State?

A. Pennsylvania.

Q. Are you the certified accountant—are you employed by the J. Robert Bazley, Inc.?

A. I am.

Q. How long have you been employed with them?

A. Since about April, 1930.

Q. Do you keep the books and records of that corporation, or are they kept by men in your office under your supervision?

A. We take the books of original entry and carry forward the bookkeeping work from that point into the general ledger.

Q. Are you familiar with the books of original entry, as well as the books that you keep?

A. I am.

[111] Q. Will you tell us when in the fiscal year 1940—in the fiscal year ending April 30, 1939, the corporation paid a dividend of $70,000?

Mr. McFarland: The books from which the witness testifies are what?

Mr. Morrison: Is the general ledger.

What did I state before?

(The reporter read the last question.)

Mr. McFarland: I have no objection to the witness stating what the book shows, but what he thinks it shows on something that doesn't appear thereon, I object to.

The Court: Let me ask you, Mr. Morrison, isn't this within the field of that stipulation?

Mr. Morrison: No, Your Honor. You recall that Mr. Bazley was asked about whether a dividend was paid immediately after the reorganization, and he was somewhat hazy about it? He knew there was $70,000, and he wasn't sure whether it was one month after or

two months after, and the exact date, and this is to show you clearly when the dividend was paid.

THE COURT: What you are asking this witness is, is to testify what the books show.

MR. MORRISON: What the book shows as being the date on which the dividend was paid.

THE COURT: That is all you want, isn't it, Mr. McFarland?

[112] MR. MCFARLAND: Well, the book merely gives an entry on April 28, 1939. What is the V?

THE WITNESS: V for voucher record.

MR. MCFARLAND: 153, dividends paid in the amount of $70,000, or is that a 4?

THE WITNESS: No, a 7, $70,000.

MR. MCFARLAND: $70,000.

THE COURT: I don't get the basis of your objection.

MR. MCFARLAND: He is testifying. I have no objection to the answer as the witness has just stated it.

THE COURT: Very well.

By MR. MORRISON:

Q. Do you know, Mr. Lefferts, from your knowledge of the company's affairs, as to whether it was paid on that date or not?

A. To make sure, I have the voucher record with me.

Q. Will you get me that, please?

A. I will corroborate this entry.

Q. Will you get it, please?

A. I will.

(The witness gets the voucher record.)

MR. MCFARLAND: Will you identify that book for the purpose of the record?

MR. MORRISON: I will.

By Mr. Morrison:

[113] Q. Mr. Lefferts, what is this book I am trying to lift up here?

A. It is entitled "Voucher Record."

Q. And is that the voucher record of the J. Robert Bazley, Inc.?

A. It is.

Q. What does that show as having been paid in the way of dividends—as of what date, April 27?

Mr. McFarland: May I just ask a question.

Do these entries appear in your handwriting?

The Witness: No.

By Mr. Morrison:

Q. They are in the handwriting of whom?

A. Of the clerk of J. Robert Bazley.

Q. Do you know who that clerk might be?

A. I am pretty sure it was a certain gentleman by the name of Chester Williams. It is either Chester William or Richard Evans.

Q. When you make your examination of the accounts of this corporation, do you examine this book? This voucher record?

A. We do.

Q. And do you know that to have been written prior to the time that you made your examination for the fiscal year [114] ending April 30, 1939?

A. I do.

Q. What date is shown here as the date of the payment of the dividend aggregating $70,000?

A. April 28, 1939.

Mr. McFarland: Mr. Lefferts, these entries made on this book are the closing entries of the month of April, 1939; is that not correct?

The Witness: No.

By Mr. Morrison:

Q. What are they?

A. These are the original entries.

Q. Are these the daily entries?

A. That is right.

Mr. McFarland: From where were these entries taken?

Mr. Morrison: From the check book.

The Witness: No. The bulk of the entries from this book arise from invoices for purchases, but it was also the custom of the corporation to enter a voucher and give it a number where any payment was contemplated. They would first record it in this book and then record the date of payment alongside of it.

Cross-Examination:

By Mr. McFarland:

Q. Directing your attention to the entries to which you have reference, from what book or from what voucher or [115] from what source were these entries made—taken?

Mr. Morrison: Give the voucher number.

The Witness: Voucher numbers 4180, 4181 and 4182.

By Mr. McFarland:

Q. Voucher No. 4180 being what voucher?

A. That is the number on the voucher given to a proposed payment to J. Robert Bazley, described hereon as being a dividend of $3,990 shares of J. R. B., Inc.

Q. The next voucher?

A. The next voucher, 4181, describes a proposed payment to Alice H. Bazley for a dividend of 1,005 shares of JRB, Inc.

Q. And the next voucher?

A. I should add that the amount of voucher 4181 is $1,470, and the amount of voucher 4180 is $55,860. The

third voucher is 4182, showing the proposed payment to Alfred Day of a dividend of five shares of JRB, Inc., $70.

Q. Can you tell from this entry, when the dividends were actually paid?

A. I can.

Q. You say, a proposed dividend?

MR. MORRISON: He said proposed payments, not a proposed dividend.

MR. MCFARLAND: All right, that is what I said.

THE WITNESS: Proposed payments. The next step in this book is to record thereon the date [116] of payments of the vouchers.

MR. MORRISON: What dates, roughly?

THE WITNESS: It is recorded that these three vouchers are paid on April 28, 1939.

MR. MORRISON: That is all?

MR. MCFARLAND: That is all as far as I am concerned.

RE-DIRECT EXAMINATION.

By MR. MORRISON:

Q. Just a moment. Can you tell us, from your own knowledge, what additions to fixed assets, such as plant, buildings, equipment, were made by J. Robert Bazley, Inc., from the time of the reorganization down to the present time or to the end of the fiscal year, April 30, 1944?

MR. MCFARLAND: Where does he get his information?

By MR. MORRISON:

Q. Where do you get your information? Have you any information pertaining to the additions to the plant of J. Robert Bazley, Inc.?

A. I do.

Q. Where do you get that information?

A. From the reports which we prepare as a result of an annual examination.

Q. Examinations of what?

A. Of the affairs of J. Robert Bazley, Inc.

Q. Contained in what? What are the affairs contained [117] in? How do you know what these affairs are?

A. From the books of the corporation.

Q. Now, do you have before you a list of these additions of plant from the time of the recapitalization down to April 30, 1944?

A. I do.

Q. Please state them.

MR. MCFARLAND: Well, I object, if the Court please. I have nothing to cross-examine him on other than the accuracy of what he has taken from the books. The books are the best evidence. I cannot cross-examine him on a thing here.

MR. MORRISON: Yes, he can, Your Honor. He cross-examined Mr. Bazley on the corporation's income tax returns a moment ago.

MR. MCFARLAND: Well, I will cross-examine him.

THE COURT: I understand when you asked this witness whether he knew these things of his own knowledge, you are withdrawing that question now and asking him whether he has any information about it.

MR. MORRISON: No, I am asking him if he knows of his own knowledge whether any additions were made to plant, and he does know that.

THE COURT: You have already asked him that, and he says he knows by hearsay. First of all, it was in the books, and then taken off the books and put in their annual audit [118] accounts, and then put on these pieces of yellow paper from which this witness is going to testify, is that right?

MR. MORRISON: Wait, if Your Honor please. I think you have overlooked something, and that is, that this is the gentleman who has knowledge of the books and records of this corporation.

THE COURT: If possible, he can go back to the books and get these figures.

MR. MORRISON: He could go back to the books and records, and that is what he has done there.

THE COURT: Has he got the books and records here?

MR. MORRISON: Have you got the books and records here?

THE WITNESS: Yes.

MR. MORRISON: Will you get them?

THE WITNESS: What about the time consumed here?

MR. MORRISON: That is not relevant. That is not your concern.

MR. MCFARLAND: Your Honor, I don't see how this has any relevancy.

THE COURT: Just a minute. You made an objection which, technically, although I haven't said so, it may be I will have to sustain as being proper from a technical standpoint, and I suppose that if I did not sustain your objection, you would be technically entitled on cross-examination to go and [119] get the books and show how he got the figures, and this is just a short cut to it anyway, but if you really don't see why this is material and if you do not think it is material, then I will ask you the question whether you find it necessary to make this technical objection.

In other words, if this witness is satisfied that these are the correct figures, and you are satisfied it doesn't make any difference anyway, I am just won-

dering if we should take the time of everybody here to get this.

Mr. McFarland: I don't want to unduly encumber the record, but maybe if we had a short recess to check the figures and see what Mr. Morrison proposes the book show, we can stipulate this or agree to cut some of the red tape.

My object is very sincere on the technical grounds, and also, what I just don't see the purpose or the relevancy of the testimony.

The Court: I can see the possibility that this testimony is material, and if it is, I am not going to prevent Mr. Morrison from putting this in, but I do want to renew a suggestion I made earlier, and that is the possibility we can recess now until two o'clock and you can use that time to go over the testimony that Mr. Lefferts will have to give anyway, with Mr. McFarland, and the member of the technical staff, and then I should suppose that they could be satisfied if these figures were accurate.

[120] Will you say, Mr. McFarland, if you can satisfy yourself from this preliminary examination of the books that these figures are accurate, you won't object to the form in which they are introduced?

Mr. McFarland: I won't object to the form in which they are introduced.

The Court: So even if you cannot stipulate it, you can save time.

Mr. Morrison: It is all right. I had hoped to save time.

The Court: I think you are just doing the opposite.

Mr. Morrison: I agree. If it is agreeable to you, that is the way we will do it.

THE COURT: I have another case coming on at two o'clock, and I am assuming what will be left will be a matter of only a few minutes. If not, I would prefer we go ahead with everything we have in this case and leave just this one question to be settled.

MR. MORRISON: Except this, Your Honor. I am going to ask, as you suggested when we were discussing our opening remarks, that in view of the evidence submitted here, in all fairness to the petitioners, the taxpayers in this case, I think they should be apprised of what is the Commissioner's position after hearing this evidence.

THE COURT: I have suggested to you at the time that [121] before I will ask the respondent to do that, I have got to be shown that you have some further evidence. If it makes a difference to you whether you produce it or not, depending on what the respondent says, because you have told a whole story here and it is just a question of the legal interpretation of these facts, I can get it from your briefs a whole lot better than I can get it by having the respondent give me legal argument here and now, but, if as I say, it makes a difference in the quantum of evidence that you put in, and you can show me what that is, I will consider the question further.

MR. MORRISON: Very well. I am going to call one witness, the secretary of the company, to identify the amount and figures of the dividend.

THE COURT: You have no objection if that witness goes on now or later?

MR. MORRISON: Do you want me to call him now or later?

THE COURT: Now, if you please.

MR. MORRISON: Mr. Day, will you take the stand?

Whereupon, ALFRED DAY, called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

[122] DIRECT EXAMINATION.

By MR. MORRISON:

Q. Mr. Day, I hand you a book——

THE COURT: Just a minute. Have we got this witness' name?

MR. MORRISON: I am sorry.

By MR. MORRISON:

Q. What is your name?

A. Alfred Day.

Q. What is your business?

A. Secretary-manager of J. Robert Bazley, Inc.

Q. Were you secretary of J. Robert Bazley, Inc. in 1939?

A. I was.

Q. What is this book I am showing you?

A. This is a report——

Q. What book is it?

A. That is a minute book.

Q. Of what?

A. Of the directors of J. Robert Bazley and the shareholders of J. Robert Bazley, Inc.

Q. Do you recall this meeting of April 25, 1939, held at the office of the company at Port Carbon, Pennsylvania?

A. I do.

Q. Is that your name signed there to the waiver of the [123] notice of the meeting?

A. It is.

Q. Now, was a dividend declared at that meeting?

MR. MCFARLAND: Well, what transpired at that meeting in relation to this contemplated dividend——

By MR. MORRISON:

Q. Was there a resolution adopted at that meeting regarding a dividend?

A. Yes.

Q. Read the resolution, please.

A. "Resolved, To immediately pay a dividend on common stock of $14 per share, or a total of $70,000, same to be paid in cash to stockholders of common record on April 25, 1939."

Q. So, was that motion duly made, seconded and adopted?

A. It was.

Q. That is all—oh, do you know of your own knowledge when that was paid?

A. No, I don't remember.

Q. Would it be a week later or a few days?

MR. MCFARLAND: If the Court please, he just said he doesn't know.

By MR. MORRISON:

Q. Do you know whether it was paid within a week?

A. The date?

[124] MR. MCFARLAND: I object.

MR. MORRISON: Your Honor, I asked him if he knew the date. Now I am asking if it was paid within a week after the declaration of this dividend.

THE COURT: I am just wondering, Mr. Morrison, what you are going to gain by this. You have already got the testimony of when the books were made up. Can you get anything but a different answer from this witness?

MR. MORRISON: That is perfectly all right.

(The witness rises.)

THE COURT: Just a minute, Mr. Day. Any cross-examination?

MR. MCFARLAND: No cross-examination.

THE COURT: Thanks.

(Witness excused.)

MR. MORRISON: May I call Mr. Lefferts, or do you suggest we take a recess until two o'clock?

THE COURT: In other words, that is your case except the line of testimony respecting the additions to plant?

MR. MORRISON: That is right.

THE COURT: Now, Mr. McFarland, I understand you are through with any cross-examination of Mr. Lefferts except on something that might bear on that open question.

MR. MCFARLAND: That is right.

THE COURT: Will you have any witnesses?

[125] MR. MCFARLAND: I don't contemplate having any testimony.

THE COURT: You know what Mr. Lefferts will testify to aside from what has already gone in?

MR. MCFARLAND: Yes.

THE COURT: I am going to ask you to put your witnesses on now, if you have any.

MR. MCFARLAND: No, we will not have any witnesses at any time.

THE COURT: Or any documentary evidence?

MR. MCFARLAND: I will ask that the returns on the individuals for the tax years be introduced as Respondent's Exhibits.

THE COURT: Have you any objection to doing that now?

MR. MCFARLAND: No.

THE COURT: What I am getting at is, I don't want to hold these other people up when they come here at two o'clock to try their case. You have no objection to the order of this?

MR. MORRISON: Not a bit.

THE COURT: That is all.

MR. MCFARLAND: You have no objection to that?

MR. MORRISON: No, I have not.

MR. MCFARLAND: Respondent offers the individual [126] income tax return of J. Robert Bazley for the year 1939 as Respondent's Exhibit A.

THE COURT: There is no objection, is there?

MR. MCFARLAND: No objection.

THE COURT: Be received and marked in evidence.

(The document referred to was marked and received in evidence as Respondent's Exhibit A.)

MR. MCFARLAND: Offer as individual income tax return of Alice H. Bazley for the year 1939 as Respondent's Exhibit B.

MR. MORRISON: No objection.

THE COURT: Received and marked in evidence.

(The document referred to was marked and received in evidence as Respondent's Exhibit B.)

MR. MCFARLAND: May leave be given to withdraw the Respondent's original photostats?

THE COURT: No objection.

MR. MORRISON: No objection.

THE COURT: It may be done.

MR. MCFARLAND: That is the Respondent's case.

THE COURT: That will be the the Respondent's case.

Now, we understand that for both parties the proceeding is being left open for the purpose of dealing with this question of additions to plant, and no other purpose, and of course, we will set the time of briefs at that time.

[127] MR. MCFARLAND: Right.

THE COURT: Take a recess until two o'clock.

(Whereupon, at 12:05 P. M., a recess was taken until 2:00 P. M. of the same day.)

[128] AFTERNOON SESSION.

MR. MORRISON: If Your Honor please, instead of asking any further questions of Mr. Lefferts, the parties have agreed to stipulate this matter, and I quote:

"It is hereby stipulated and agreed by the parties hereto that the net additions to plant and equipment increased from $719,782.41 at April 30, 1939 to $1,051,933.03 at April 30, 1944."

The petitioner rests.

MR. MCFARLAND: Respondent rests.

THE COURT: Very well. What about briefs?

MR. MCFARLAND: Shall we submit them under the rules, if the Court please?

MR. MORRISON: Under the rules, 30 days.

THE COURT: Satisfactory. Very well, 45 days for the principal briefs and 15 days for each side to reply.

THE CLERK: October 27th for the original briefs and November 11th for the reply.

(Whereupon, at 2:10 P. M., the hearing in the above-entitled matter was closed.)

MEMORANDUM FINDINGS OF FACT AND OPINION.

4 T. C. No. 108.

THE TAX COURT OF THE UNITED STATES.

Alice H. Bazley,
Petitioner,
v.
Commissioner of Internal Revenue,
Respondent.

J. Robert Bazley,
Petitioner,
v.
Commissioner of Internal Revenue,
Respondent.

Docket Nos. 1520 and 1521. Promulgated February 28, 1945.

Distribution to petitioners of debenture bonds along with new common stock upon the surrender and redemption of old common stock of corporation, of which petitioners were virtually sole stockholders, *held*, not a reorganization resulting in a tax-free exchange under section 112, since lacking a true business purpose, but essentially equivalent to a taxable dividend under section 115 (g). *Gregory v. Helvering*, 296 U. S. 465, followed.

Frederick E. S. Morrison, Esq., and *Calvin H. Rankin, Esq.*, for the petitioners.
W. J. McFarland, Esq., for the respondent.

By these consolidated proceedings petitioners challenge respondent's determination of deficiencies in their income tax for the year 1939 as follows:

J. Robert Bazley	$214,170.52
Alice H. Bazley, his wife	35,734.40

J. Robert Bazley will sometimes hereinafter be referred to for convenience as petitioner.

The primary question involved is whether the petitioners are taxable as charged by respondent with having received ordinary income during the taxable year to the extent of the face value of bonds of J. Robert Bazley, Inc., received in that year. A subsidiary question is whether the transaction, pursuant to which the bonds were transferred to petitioner, constituted a tax-free reorganization.

The record was made on a stipulation of facts and evidence adduced at the hearing. Those facts hereinafter appearing which are not from the stipulation are otherwise found from the record.

FINDINGS OF FACT.

The stipulated facts are hereby found accordingly.

Each of the petitioners for the calendar year 1939 filed a separate income tax return with the collector of internal revenue for the first district of Pennsylvania on or before March 15, 1940. Their books and their income tax returns were on a cash basis except for a hauling business which petitioner conducted as a sole proprietor and which is on an accrual basis. J. Robert Bazley, Inc., is on an April 30th fiscal year basis of accounting and files its Federal tax returns on that basis. Petitioners reside in Pottsville, Pennsylvania.

J. Robert Bazley, Inc., was incorporated under the laws of the Commonwealth of Pennsylvania on May 1, 1930, with an authorized capital of 1,000 shares of a par value of $100 per share. On February 1, 1939, this stock was owned as follows:

Petitioner	798 shares
Alice H. Bazley	201 shares
Alfred Day	1 share

All of the foregoing constituted the board of directors of the corporation.

Petitioner was the president and treasurer. He is a contracting engineer with a degree of mechanical engineering from the University of Michigan and 33 years' experience as a mining and consulting engineer. The corporation engaged in general heavy contracting business, including road building, the moving of industrial facilities, installation of heavy foundations and steel work, and removing the overburden from coal to facilitate its mining by the open-pit method. Shortly prior to the year 1939 the corporation was almost entirely engaged in its mining operations. At this time it first considered going into the road building work which is hazardous and requires considerable working capital. Many road building contractors have failed.

The yearly average of the corporation's employees during the years 1937 to 1940 approximated 400, of which approximately 25 were classified as key employees, including superintendents, engineers, and foremen. The latter's average yearly compensation was $4,500. The corporation maintained throughout the period 1938 to 1941, inclusive, a consistent rate of compensation for its employees.

Reasons for adopting the transaction hereinafter described involving the issuance of additional common stock and of debenture bonds were that the original shareholders, by obtaining debenture bonds for their stockholdings, would receive a security which was much less fluctuating and more readily marketable, particularly in case it was necessary for a deceased shareholder's estate to liquidate his investment in the corporation in order to meet inheritance taxes or for other purposes, and that if it became necessary to sell some portion of their investment in the corporation the debenture bonds could be sold without reducing the Bazley family stock control of the corporation; that the contemplated entry into the hazardous road building business made it desirable to put the original stockholders in possession of

bonds which would place them in a position of sharing alike with creditors to the extent of the debentures instead of ranking after creditors if the business did not succeed; that as of February, 1939, the corporation had plant and equipment of a value ($719,782.41 as of April 30, 1939), which was large in relation to the $100,000 par value of the capital stock outstanding, and since the equipment had been purchased by the use of funds acquired through the accumulation of $855,783.07 of earnings and profits since the organization of the business in 1930, it was thought advisable to reflect a more permanent dedication to corporate use of these earnings by reducing the surplus available for dividends and transferring a portion thereof to the capital stock account and another portion to the long-term debt represented by 20-year debenture bonds.

On February 6, 1939, a special meeting of the corporation's board of directors was held at which petitioner announced that the meeting was called to discuss the advisability of reorganizing and recapitalizing the corporation. He read to the board the proposed plan of reorganization and advocated its adoption, stating that the plan had been discussed with counsel for the company and with the company's accountants and that the consensus of their opinion was that the plan was advantageous to the corporation and its stockholders. A motion was duly presented and unanimously carried that the plan be adopted. Authority was also granted to make the necessary increase in the capital stock of the company.

The plan of reorganization recited that the capitalization as of February 1, 1939, was 1,000 shares of $100 par value common stock, or $100,000 and earned surplus of $855,783.82. The plan provided for issuance of 5,000 shares of common stock of no par value (with a stated value of $300,000) earned surplus of $255,783.82 and $400,000 principal amount of 6 percent debenture bonds. The corporation was to issue in exchange for the old stock, the new stock and the debenture bonds after which the old stock

was to be cancelled. Bonds were to be dated February 1, 1939, and payable February 1, 1959. They were callable in whole or in part and bore interest at the rate of 6 percent per annum. On February 16, 1939, the owners of the outstanding capital stock of the corporation held a special meeting pursuant to resolutions adopted by the board of directors at the February 6, 1939, meeting and took formal action, approving the proposed plan of reorganization and passed resolutions authorizing the necessary corporate action for its consummation.

On March 6, 1939, the Commonwealth of Pennsylvania approved the amendments to the company's Articles of Incorporation increasing the authorized common stock.

In accordance with the resolution adopted at the meeting of the shareholders of J. Robert Bazley, Inc., held on February 16, 1939, the capital structure of the company, which prior to the consummation of the terms of said agreement, was as follows—

1,000 shares common stock of par value of $100 per share	$100,000.00
Earned Surplus	855,783.82
Total	$955,783.82

was changed as shown by the corporation's books of account, as follows:

5,000 shares common stock without nominal or par value, the stated capital applicable to which is	$300,000.00
Earned Surplus	255,783.82
Outstanding Debenture Bonds	400,000.00
Total	$955,783.82

Pursuant to the plan, the stockholders on March 16, 1939, delivered their 1,000 shares of common stock to the corporation and received from the corporation the 5,000 shares of its new common stock and debenture bonds in

the aggregate principal amount of $400,000. The old common stock was cancelled by the corporation.

The following schedule reflects the distribution of the common shares and the 20-year 6 percent debenture bonds of the corporation prior and subsequent to the consummation of the plan:

		Received Under Agreement of 2/1/39	
Name	Old Stock Held Shares	New Stock Shares	Debentures Principal Amount
J. Robert Bazley	798	3,990	$319,200.00
Alice H. Bazley	201	1,005	80,400.00
Alfred Day	1	5	400.00
Total	1,000	5,000	$400,000.00

The 5,000 shares of the new common stock and the $400,000 face amount 20-year debenture bonds so issued had a fair market value on March 16, 1939, of not less than $300,000 for the common stock and $400,000 for the bonds.

J. Robert Bazley, Inc., and petitioners have never sold or offered to sell any of its stock to its key employees. After the recapitalization petitioner went to Europe in the summer of 1939 and when he returned he did not believe the business situation was favorable, due in part to the unsettled situation in Europe.

The net additions to plant and equipment of J. Robert Bazley, Inc., increased from $719,782.41 at April 30, 1939, which had been purchased by the use of the accumulation of earnings and profits since the organization of the business in 1930, to $1,051,933.03 at April 30, 1944.

On April 25, 1939, the board of directors of J. Robert Bazley, Inc., declared a dividend on the common stock of $14 per share, or a total of $70,000, which was paid in cash on April 28, 1939.

The earnings and dividends of J. Robert Bazley, Inc., for the fiscal years ending April 30, 1934, through and including 1944, were as follows:

Year Ending April 30	Earnings	Interest	Total	Dividends Paid	Dividends per Share
1934	$117,908			None	None
1935	(—4,828)			None	None
1936	106,891			$10,000	$10
1937	96,894			75,000	75
1938	6,578.17			65,000	65
Average for first five years	$ 64,688.634				
1939	104,178			70,000	14*
1940	1,528	$24,000	$ 25,528	10,000	2
1941	45,015	24,000	69,015	25,000	5
1942	43,884	24,000	67,884	15,000	3
1943	140,549	24,000	164,549	70,000	14
1944	102,890	24,000	126,890	70,000	14
Average for last five years			$ 90,773.20		

*Paid on the 5,000 shares issued in the recapitalization.

There was no legitimate purpose of the corporate business of J. Robert Bazley, Inc., in the issuance and distribution to the stockholders of $400,000 in debenture bonds.

Respondent in his notice of deficiency increased the taxable incomes of petitioner and his wife by $319,200 and $80,400, respectively, "representing the fair market value of bonds of J. Robert Bazley, Inc., received in exchange of common stock of that corporation."

OPINION.

OPPER, *Judge:* It is respondent's position that although the exchange of the common stock held by petitioner in J. Robert Bazley, Inc., for new common stock and bonds of the same company conforms superficially to the provisions specifying non-recognition of gain, the transaction lacked a legitimate business purpose and hence fails to comply with the true statutory requirements. *Gregory v. Helvering*, 293 U. S. 465. Looking only at the language of the reorganization section, there was a technical recapitalization, that is, a reorganization within the statutory definition of section 112 (g) (1) (D). *Annis Furs, Inc.*, 2 T. C. 1096; *Clarence J. Schoo*, 47 B. T. A. 459, appeal dismissed (C. C. A., 1st Cir.). And since there was an exchange of stock for stock and securities in the same corporation, the language of the section forbids recognition of gain or loss. Section 112 (b) (3).

But that mere formal compliance is not sufficient, at least since the decision in the *Gregory* case. Hence the real issue is whether it has been satisfactorily established that there was a true business purpose for the operation by which petitioners were enabled to substitute for the entire outstanding stock of the corporation other stock possessing the same attributes and, in addition, instruments in the form of bonds representing newly-created fixed obligations of the corporation as to both principal and interest. A mere desire to effect a change in the form in which their property interests were held, but in such a manner as to escape the tax consequences otherwise called for, would not under the *Gregory* case furnish the necessary validating purpose. *Louis Wellhouse, Jr.*, 3 T. C. 363. In that situation it would be of no consequence whether the transaction should be treated in part as an exchange of stock for stock

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[1] Internal Revenue Code.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(b) Exchanges Solely in Kind.—

* * * * *

under section 112 (b) (2) since no claim is made that any gain was realized upon that phase of the transaction. If in course of the surrender, cancellation, and redemption of the old stock and the issuance of the new stock and bonds, petitioners received a distribution which was essentially equivalent to the declaration of a taxable dividend,[2] as respondent contends they did by means of the receipt of the bonds, the fair market value of that distribution would be taxable to them as a dividend under the provisions of section 115 (g).

Thus, in *Edith B. Bass*, 45 B. T. A. 1117, we held under somewhat similar circumstances that the redemption of stock of the taxpayer, accompanied by the issuance of other stock, was in part essentially the equivalent of a taxable dividend. This decision, it is true, was reversed (C. C. A., 1st Cir.), 129 Fed. (2d) 300, but upon the reasoning that since there was no effort there to capitalize accumulated earnings and the earned surplus remained available for future dividend action on the part of the corporation, the similarity to a dividend disappeared. The Court said in part (304, 305, 309):

> * * * Congress itself has defined the term "dividend" in § 115 (a) of the Act as meaning any *distribution* made by a corporation to its shareholders, whether in money or in other property, *out of its earnings or profits*. * * *
>
> * * * * * * *

"(2) Stock for stock of same corporation.—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation."

[2] Internal Revenue Code.

"SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * *

"(g) Redemption of Stock.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend."

Whether profits are to be capitalized is not a mere matter of bookkeeping; there are important business differences according as one course or the other is pursued. If profits are capitalized by means of a stock dividend such profits are no longer available for the declaration of a dividend at the discretion of the directors but become part of the permanent capital of the corporation, thereby tending to enhance the corporation's credit. If profits are not capitalized they may be distributed as dividends some time in the future; and it would be a contradiction in terms to say there has been in any sense a "distribution" out of "earnings or profits" when such earnings have been expressly held intact in the surplus account for possible future distribution.

* * * * * *

Gregory v. Helvering, 1935, 293 U. S. 465, 55 S. Ct. 266, 79 L. Ed. 596, 97 A. L. R. 1355, cited by the Board, is no authority for the position taken. * * * In substance, assets of the corporation were distributed to its shareholders and the corporation's surplus was correspondingly reduced. In these circumstances the distribution was held taxable as a dividend. In the case at bar, however, there was a permanent revision of the capital structure pursuant to a plan of recapitalization having a genuine business purpose. The transaction was not a tax-dodging subterfuge. There was in fact no "distribution" out of "earnings or profits."

* * * * * *

* * * Of course, the fact that there has been no increase in the aggregate wealth of the shareholders does not in itself establish that they have not received a dividend. United States v. Phellis, 1921, 257 U. S. 156, 171, 42 S. Ct. 63, 66 L. Ed. 180. On the other hand, neither does this fact establish that the stockholders *have* received a dividend. On that issue the fact is colorless. What distinguishes the present transaction

from a stock dividend is that here no portion of the surplus was capitalized.

Under the present facts this reasoning would be inapplicable. Not only did the issuance of fixed obligations inevitably capitalize and imprison a corresponding amount of earned surplus, by reason of the proportionate increase in liabilities as compared with assets and the consequent reduction of surplus; but a specific and declared purpose of the operation was to incorporate in the bonded indebtedness the company's investment in machinery and equipment which was recognized to have been paid for out of accumulated earnings.[3] If the principles upon which the *Bass* case was reversed are followed and the test there designated is applied, the result thus remains the same. Cf. *Louis Wellhouse, Jr., supra*. The elimination by the process here adopted of an equivalent segment of accumulated earnings which would otherwise have been available for the declaration of subsequent dividends requires that this action itself be characterized as a distribution out of earnings and hence as the equivalent of the declaration of a taxable dividend.

On the present record and upon detailed review of all of the aspects urged on behalf of petitioners, we have felt compelled to the conclusion set forth in our findings of fact that no legitimate corporate business purpose existed for the so-called recapitalization. Such objectives as to create a security more desirable for the stockholders as being less fluctuating in value, more regular and certain in its income, easier to market for inheritance tax payments and furnishing greater safety against claims of corporate creditors are

[3] "Yes, at this time the fixed assets of the corporation were very large in relation to the amount of stock outstanding—that is, to the face value of the stock, due to the fact that there had been an accumulation of profits that had all been turned back into the business, new equipment purchased.

"We might add that the equipment used in this particular type of work is very expensive and requires a great deal of working capital. * * *

"* * * so these fixed assets were here and had been built through accumulation, and it seemed very advisable to reflect this accumulation of earnings in the permanent dedication of these funds and put it into corporation use." Testimony of petitioner, J. Robert Bazley.

easily understandable from the standpoint of the stockholders. They furnish persuasive reasons why the stockholders wanted to change the form of their investment. But, as we have said, a desire to encompass such an exchange without occasioning the tax consequences usually attendant upon those transactions would not supply the necessary purpose as a business or corporate object. And certainly it would be a contradiction in terms to agree with petitioner that the desire to incorporate the undistributed profits into invested capital so as to render them immune from future invasion could be such a business purpose when this very act can be regarded as creating the resemblance to a dividend which the statute subjects to tax. *Bass v. Commissioner, supra.*

The purpose most insistently advanced as justifying the exchange was the asserted desire to make the new stock available in larger volume and smaller units for distribution among key employees whose interest in the company it was desired to retain. Such an object would be acceptable as a legitimate purpose of the corporate business. *Jacob Fisher,* 46 B. T. A. 999. But we are unable to satisfy ourselves that such a purpose was ever in fact entertained. After five years, the distribution has never taken place. And no excuse advanced to justify the delay is convincing. Every one points rather in the direction of the assumption that one or another of the same reasons can always be resorted to to cause a further postponement. And most suggest that if valid, they should have operated to postpone or prevent the "recapitalization" itself, rather than the subsequent distribution.

Thus it is suggested that in the spring of 1939, when the new stock became available, the company's contracts were up for renewal, in the fall the European war commenced, by the following spring the company's earnings statement was unfavorable, and by the end of 1941 this country itself entered the war. But the contract situation was known before the new stock was authorized; the out-

break of war was a factor in the business picture, both uncertain in its effect and typical of other business hazards; the coal business was known to be "up and down"; and the average earnings for the significant years and particularly those for fiscal 1941 are not appreciably at variance with the figures for the company's previous history.

The hazardous nature of the road building business upon which the company was about to embark furnishes an adequate ground for the apprehension on the part of the stockholders which led to the partial transformation of their investment into fixed obligations, but it is diametrically at variance with the assumption that at the same time the earnings could be so stable and secure as to meet the stated prerequisite for participation on the part of the employees. Finally, the increased corporate earnings since the entry of this country into the war would seem to furnish the anticipated inducement to institute the plan at least by that time, and the fear that war bond purchases might suffer is hard to credit. We are consequently forced to the conclusion that the undisputed facts speak with a clearer voice than the unsupported testimony of petitioner; and that since the two are inconsistent, the former must shape our ultimate decision. We have accordingly found a complete absence of legitimate corporate business purpose within the *Gregory* principle.

Such cases as *Clarence J. Schoo, supra, Edgar M. Docherty*, 45 B. T. A. 462, appeal dismissed (C. C. A., 1st Cir.), and *Annis Furs, supra*, may be distinguished from the present proceeding on grounds similar to those upon which *Jacob Fisher, supra*, was distinguished from *Edith B. Bass, supra*. Here, as in the *Bass* case, "the record fails to disclose any business purpose of substance" in the transaction. Without attempting to set out the details appearing in the facts of the various cases cited, it is enough to say that in each a benefit to the corporation of greater or less consequence appears as an anticipated result of the reorganizations there undertaken. In the present proceed-

ing, as we have found, the benefits to the business are negligible and insubstantial. The individual stockholders may well have endeavored to establish a foundation for participating in the corporate profits without subjecting the distributions to taxation as dividends. For a subsequent redemption of the bonds would not only fail to qualify as the equivalent of a taxable dividend under 115 (g) but would fall precisely within the terms of section 117 (f) as an item of capital gain,[4] with the accompanying limitations on taxability.[5] But such a purpose, if it existed, would fail to release the operation from the rule in the *Gregory* case. "Putting aside, then, the question of motive in respect of taxation altogether * * * what do we find? Simply an operation having no business or corporate purpose * * * not to reorganize a business or any part of a business, but to transfer a parcel of corporate * * * [securities] to the petitioner."

Reviewed by the Court.

Decision will be entered for the respondent.

DISNEY, *J.*, concurs only in the result.

BLACK and TYSON, *JJ.*, dissent.

SMITH, *J.*, dissenting: The majority opinion recognizes that on the facts there was a "technical" recapitalization and reorganization of J. Robert Bazley, Inc. in 1939 but holds that the reorganization lacked "a legitimate business purpose" and therefore must be denied recognition for tax purposes, under the doctrine of *Gregory v. Helvering*, 296 U. S. 465.

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[4] Internal Revenue Code, section 117 (f).

"(f) Retirement of Bonds, Etc.—For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

[5] Internal Revenue Code, section 117 (a).

In the *Gregory* case the court disregarded, as a mere sham, a corporate entity which was created for the sole purpose of effecting a tax-free transfer of corporate assets to stockholders and which was dissolved immediately after it had served its purpose in carrying out the artifice.

I do not think that the principle of the *Gregory* case is applicable here. It seems to me that the evidence shows a legitimate business reason, perhaps several legitimate business reasons, for the recapitalization. Some of those reasons are plainly set out in the findings of fact. The evidence discloses a further reason, which is not shown in the facts; namely, that under the recapitalization there was set up the basis for an annual deduction of $24,000 of interest on the debenture bonds which were issued in exchange for common stock. Petitioner J. Robert Bazley testified:

> A. Furthermore, it seemed to us in conference with this management, that this plan of issuing common stock and debentures would also secure for the corporation certain benefits inasmuch as the fixed charges on the bonds would have the purpose of reducing Federal and State taxes, and it would also enlarge the percentage of dividends on the reduced value of the stock inasmuch as the value of the stock had been reduced.

It seems to me that this reason alone, that is, the reduction of taxable income, might be deemed sufficient to give substance to the recapitalization. The court observed in the *Gregory* case that: "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted," citing *United States v. Isham*, 17 Wall. 496; *Superior Oil Co. v. Mississippi*, 280 U. S. 390; *Jones v. Helvering*, 71 Fed. (2d) 214.

In *Commissioner v. Capento Securities Corporation*, 140 Fed. (2d) 382, the Circuit Court of Appeals for the First Circuit held, affirming 47 B. T. A. 691, that the issuance by a corporation of its preferred stock for its out-

standing bonds constituted a recapitalization, and therefore a statutory reorganization. The purpose of the recapitalization there, which was held to be a legitimate one, was to facilitate the securing of loans from the banks. Distinguishing *Gregory v. Helvering, supra*, where "the purported 'reorganization' though following the literal language of the statutory definition, was an operation having no business or corporate purpose," the court observed that:

> * * * There resulted a permanent revision of the capital structure of Raytheon Production Corporation pursuant to a plan of recapitalization—a normal business procedure dictated by the necessity of raising new capital. In such circumstances it is the purpose of the nonrecognition provisions of the Act to save the taxpayer from an immediate recognition of a gain, where, in a popular and economic sense, there has been a mere change in the form of ownership and the taxpayer has not really "cashed in" on the theoretical gain, though a gain may have accrued in a constitutional sense. * * *

See also *Bass v. Commissioner* (C. C. A., 1st Cir.), 129 Fed. (2d) 300.

I think that the finding of the Tax Court in this case that the reorganization of *J. Robert Bazley, Inc.* lacked a true business purpose is contrary to the evidence.

ARUNDELL and VAN FOSSAN, *JJ.*, agree with this dissent.

DECISION.

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated February 28, 1945, it is

ORDERED and DECIDED: That there is a deficiency in income tax of $214,170.52 for the year 1939.

(Signed) CLARENCE V. OPPER,
Judge.

Enter:

Entered: Mar. 2, 1945.

Copies served on both parties.

[fol. 106] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1945

No. 8947

J. ROBERT BAZLEY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the Decision of the Tax Court of the United States

Argued November 20, 1945

Before Biggs, McLaughlin and O'Connell, Circuit Judges

OPINION OF THE COURT—Filed January 8, 1946

By O'CONNELL, Circuit Judge:

This is a petition to review the decision of the Tax Court of the United States sustaining the Commissioner's determination of deficiencies in the income tax of J. Robert [fol. 107] Bazley for the year 1939.[1] The question for our determination is whether the petitioner is properly chargeable with having received ordinary income during the taxable year to the extent of the face value of certain bonds of J. Robert Bazley, Inc., distributed to petitioner in that year.

Shortly prior to February 1, 1939, J. Robert Bazley, Inc., was engaged in general heavy contracting business with most of its operations consisting of coal mining by the open-pit method. The corporation's stock was owned by J. Robert Bazley, Alice H. Bazley, his wife, and Alfred Day, all of whom constituted the Board of Directors. On February 16, 1939, owners of the outstanding capital stock of the corporation held a special meeting pursuant to resolutions adopted by the board of directors on February 6, 1939, and

[1] The Tax Court also decided substantially the same question as that involved herein but relating to Alice H. Bazley, wife of the petitioner. A petition for review of the Tax Court's decision with respect to her 1939 tax liability is also pending but, by stipulation approved, the judgment in the case at bar is controlling in the case of Alice H. Bazley.

formally approved a proposed plan of reorganization. Resolutions authorizing the necessary corporate action for consummation of this plan were passed. On March 6, 1939, the Commonwealth of Pennsylvania approved the amendments to the Company's Articles of Incorporation increasing the authorized common stock.

The reorganization is reflected in the table set forth below which indicates stock ownership and capitalization of the corporation before and after the occurrence of the transaction under scrutiny here.

	Old	New	
Name	Shares	Shares	Debenture Principal Amount
J. Robert Bazley	798	3,990	$319,200.00
Alice H. Bazley	201	1,005	80,400.00
Alfred Day	1	5	400.00
Total	1,000	5,000	$400,000.00

[fol. 108] Capital Structure of Corporation

February 1, 1939 (Before proposed reorganization)

1,000 shares common stock par value of $100 per share	$100,000.00
Earned Surplus	855,783.82
	$955,783.82

March 16, 1939 (after reorganization)

Outstanding Debenture Bonds	$400,000.00
5,000 shares common stock without nominal or par value, the stated capital applicable to which is	300,000.00
Earned Surplus	255,783.82
	$955,783.82

On March 16, 1939, the stockholders delievered their 1,000 shares of odd common stock to the corporation and received from the corporation the 5,000 shares of the new common stock and debenture bonds in the aggregate principal

amount of $400,000. The old common stock was cancelled by the corporation.

The Tax Court found[2] there was no legitimate purpose of the corporate business of J. Robert Bazley, Inc., in the "recapitalization" resulting in the issuance and distribution to the stockholders of $400,000 in debenture bonds. According to the testimony, it appears that the corporation was contemplating entry into road building work, a financially hazardous business and one requiring considerable working capital. The following reasons motivated the recapitalization: (1) the stockholders, by obtaining debenture bonds for their stock, would receive a more readily marketable and less fluctuating security in case it would become necessary for the estate of a deceased shareholder to liquidate his investment to meet inheritance taxes or for other purposes; (2) the bonds could be sold without reducing the Bazley family's stock control of the corporation; (3) the contemplated entry into the hazardous business of road construction made it desirable for stockholders to possess bonds in order to be in a position at least equal to general creditors in the event of insolvency; (4) the value of the corporation's plant and equipment ($719,782.41 as of April 30, 1939) was large as compared with its capitalization of $100,000, and since such equipment had been purchased by using funds acquired through accumulation of $855,783.07 of earnings and profits, it was deemed advisable to reflect a dedication of these earnings to corporate use by reducing surplus available for dividends and transferring a part thereof to capital stock and a part to long-term debt represented by the 20-year bonds. Two additional motives advanced by the petitioner as reasons for the questioned transaction were (a) to provide stock of a type available for sale to the company's key employees and (b) to reduce the company's taxable income by $24,000 through the interest payments on the debenture bonds. The majority of the Tax Court refused to accept these two purposes as having existed in fact[3] and, on the whole record, concluded that

[fol. 109]

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[2] Five judges dissenting.

[3] The Tax Court was greatly influenced in the rejection of the first of these two asserted motives by the fact that the Bazleys, after five years, have never made any distribution of the new common stock to key employees and that

[fol. 110] no legitimate corporate business purpose existed for the recapitalization.

The Commissioner contends that the distribution of the $400,000 face value 20-year debenture bonds constituted a taxable dividend. No attempt is made to impose a tax on any part of the new stock distributed to the petitioner.

Petitioner asserts that the entire transaction was in pursuance of a *bona fide* corporate reorganization in the nature of a "recapitalization" [Section 112(g) (1) (E)[4]] and therefore tax-free under the provisions of Section 112. (b) (3),[5] or if by reason of the absence of a legitimate corporate business purpose the transaction is not a reorganization, it is an exchange of stock for stock and other property under Section 112 (b) (2) and thus taxable only as capital gain under Section 112 (c) (1) and 117.[6]

The issue here is sharply defined: The Commissioner maintains that, absent a legitimate corporate business purpose, there can be no tax free reorganizational transaction, under the doctrine of Gregory v. Helvering, 293 U. S. 465 (1935). Petitioner, however, argues that the *Gregory* deci-

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proffered excuses for such failure to carry through the asserted intention lacked plausibility. As to the other asesrted motive the majority opinion is silent. Judge Smith, dissenting, felt that the evidence disclosed a legitimate corporate business purpose in the reduction of taxable income of the corporation by payment of $24,000 annual interest on the debenture bonds. The reasoning of the majority of the Court in rejecting this as a motive in fact for the corporation's recapitalizing may be found in the later decision of the same court with a similar dissent in Adair A. Adams, 5 T. C. 351 promulgated June 29, 1945. There, the majority of the Tax Court pointed out the obvious *disadvantage to the corporation* in undertaking an annual obligation to pay interest on a substantial sum of money in order to obtain a tax reduction in a much smaller amount. For the purposes of this case, the fact findings do not include one that the corporation's motive in effecting the recapitalization was to reduce Federal income taxes.

[4] 26 U. S. C. (1940 ed.) Sec. 112 (g) (1) (E).

[5] 26 U. S. C. (1940 ed.) Sec. 112 (b) (3).

[6] 26 U. S. C. (1940 ed.) Sec. 117.

sion is inapplicable where there exists a legitimate business purpose of the *stockholders* for the reorganization ("reasons other than tax avoidance", to use the petitioner's phrase).

It is true that, literally, the questioned transaction is a "recapitalization". But the sanctuary of the tax free "reorganization" is not available to a taxpayer merely because the form of the transaction matches literally, the wording of the Revenue Act. What Judge Goodrich said in Commissioner v. Gilmore's Estate, 130 F. 2d 791, 794 (C. C. A. 3, 1942) is here pertinent: "It is now settled that whether a transaction qualifies as a reorganization under the various Revenue Acts does not turn alone on compliance with the literal language of the statute. The judicial interpretation has determined that something more may be [fol. 114] needed and that, indeed, under some circumstances, something less will do. Our concern in this case is the 'something more' since we have concluded that there was a literal compliance. The starting point is Gregory v. Helvering, 1935, 293 U. S. 465."

As we view the *Gregory* decision, the taxpayer's motive to avoid taxation by the questioned device is not the test. The true inquiry questions the connection between the corporation's business interests and the transaction under scrutiny. In short, the petitioner confuses the shareholders' objective in assenting to the transaction with the corporation's purpose in accomplishing it; *cf.* Chisholm v. Commissioner, 79 F. 2d 14, 15 (C. C. A. 2, 1935); certiorari denied, 296 U. S. 641 (1935), where Judge Learned Hand who wrote the opinion affirmed by the Supreme Court in the *Gregory* case [7] pointed this out, referring to the accompanying purpose to escape taxation as a "legally neutral" fact.

Analysis of the numerous cases which follow *Gregory* reveals that they turn on whether or not what was accomplished by the questioned transaction was designed to meet a corporate "business exigency": see, for example, Commissioner v. Gilmore's Estate, *supra*; and Commissioner v. Capento Securities Corp., 140 F. 2d 382 (C. C. A. 1, 1944), in which a legitimate corporate business purpose existed for the "reorganization" and the transaction questioned in each was upheld as a tax free "reorganization" within the mean-

[7] Helvering v. Gregory, 69 F. 2d 809 (C. C. A. 2, 1934).

ing of the Revenue Acts.[8] The quest for a legitimate business purpose of the corporation in effecting the "reorganization" has been made consistently by the Tax Court as well: see, for example, Marion Healy, T. C. Dkts. 5812-5813 promulgated July 24, 1945; Adam A. Adams, 5 T. C. 351 (1945); Louis Wellhouse, 3 T. C. 363 (1944); and Jacob Fisher, 46 B. T. A. 999. The Treasury Regulations, also, [fol. 112] embody this concept: Reg. 103, Sec. 19, 112 (g)-1, 112 (g)-2.

Accordingly, we must look for such a legitimate business purpose of the corporation as distinct from the mere personal desires of the shareholders. The Tax Court expressly found that there was no such corporate business purpose for the "recapitalization" in this case. Our review of the record reveals substantial support of this finding.

The precise question for our determination is thus whether the distribution of the debenture bonds following the cancellation of the old common stock occurred "at such time and in such manner as to make the distribution and cancellation . . . . essentially equivalent to the distribution of a taxable dividend . . . .": Internal Revenue Code, Sec. 115 (g).[9] No "sole decisive" test for such a determina-

[8] As Judge Goodrich pointed out in the Gilmore case, the Gregory decision does not go so far as to require a legitimate corporate business purpose for the particular method used to accomplish what in fact was done by a "reorganization". It is sufficient if *what was accomplished* by the "reorganization" met a corporate "business exigency".

[9] 26 U. S. C. (1940 ed.) Sec. 115 (g).

> "(g) Redemption of Stock.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend."

So far as the issuance to the petitioner of the common stock is concerned, the table in the text shows that no change

tion has been laid down either by the Tax Court or the appellate courts: Flanagan v. Helvering, 116 F. 2d 937 (App. D. C. 1940), per Vinson, J. The history of Section 115 (g), beginning with the Acts of 1926, throws some light on the desired objective of Congress in passing such legislation. In the House, Senate and Conference Reports [10] an [fol. 113] illustration of the type of situation intended to be covered by this section was given thus: Suppose "... the case of two men holding practically the entire stock of a corporation for which each paid $50,000. The corporation, having accumulated a surplus of $50,000 above its cash capital, buys from the stockholders for cash one-half the stock held by them and cancels it, and the payment is non-taxable because it is a partial redemption of stock. To change this result and make it taxable [Sec. 115] (g) was written and incorporated into the law." [11]

We see no real distinction between a case where the corporation pays cash for its outstanding stock and where the corporation pays in the form of debenture bonds for its old stock: see Doerschuck v. United States, 274 Fed. 739 (E. D. N. Y. 1921). In each case the application of Section 115 (g) to the transaction under scrutiny depends on the particular facts. McGuire v. Commissioner, 84 F. 2d 431 (C. C. A. 7, 1936); certiorari denied, 299 U. S. 591 (1936).

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in proportional ownership took place and, under the circumstances, distribution of the new common stock could not be regarded as "essentially equivalent to the distribution of a taxable dividend": *cf.* Eisner v. Macomber, 252 U. S. 189, 211 (1919); but *cf.* Bass v. Commissioner, 129 F. 2d 300, 304, 305 (C. C. A. 1, 1942).

[10] H. Rep. No. 1, 69th Cong., 1st Sess. p. 5; S. Rep. No. 52, 69th Cong., 1st Sess. p. 15; H. Conference Rep. No. 356, 69th Cong., 1st Sess. p. 30.

As pointed out in f. n. 3 of Flanagan v. Helvering, *supra*, the illustration was made in connection with the Act of 1926, Sec. 201 (g), 44 Stat. 11, 26 U. S. C. A., Int. Rev. Acts, page 147. In relevant portions this is identical with the corresponding section of the 1939 Revenue Act, 26 U. S. C. (1940 ed.) Sec. 115 (g).

[11] For an example of the applicability of the illustration to an actual case, see Hyman v. Helvering, 71 F. 2d 342 (App. D. C. 1934); certiorari denied, 293 U. S. 570 (1934).

Moreover, the question of whether a distribution in connection with the cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend is one of fact: Brown v. Commissioner, 79 F. 2d 73 (C. C. A. 3, 1935); Commissioner v. Champion, 78 F. 2d 513 (C. C. A. 6, 1935); Commissioner v. Babson, 70 F. 2d 304 (C. C. A. 7, 1934); Randolph v. Commissioner, 76 F. 2d 472 (C. C. A. 8, 1935); Hirsch v. Commissioner, 124 F. 2d 24 (C. C. A. 9, 1941). Consequently, we are powerless to disturb the Tax Court's determination of such a factual question if substantial evidence to support its conclusion exists: Helvering v. Kehoe, 309 U. S. 277 (1940). Nor will we controvert the Tax Court's determination by "treating as questions of law what really are disputes over proper accounting": see Dobson v. Commissioner, 320 U. S. 489, 499 (1943).

As we view the record in this case, there is not only substantial evidence to support the Tax Court's determination but, indeed, it would be difficult to reach any other con- [fol. 114] clusion. Under Section 115 (a) [12] a distribution out of accumulated earnings and profits is a "dividend". "Recapitalization does not alter the 'effect' ": Commissioner v. Estate of Bedford, 325 U. S. 283, 292 (1945). The net worth of the corporation, i. e., the value of the stock in the hands of the stockholders, prior to the reorganization, was $955,783.82. This value, after reorganization, was $555,783.82. Clearly, the corporation has thus distributed $400,000 out of accumulated earnings and profits. The face and market value of the bonds is admittedly $400,000. By their distribution to the stockholders, the corporation

[12] 26 U. S. C. (1940 ed.) Sec. 115 (a)

"(a). *Definition of Dividend.*—The term 'dividend' when used in this chapter (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913; or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made."

effectively consumed that much of the earned surplus which would otherwise be available for declaration of subsequent dividends. Petitioner admits this.

To issue bonds, it would not have been necessary to adjust the value of the capital stock ($100,000) on the books of the corporation. Normally, the bonds would have been sold for cash, in which event no charge would have been made against earnings. But had the normal procedure been followed, to transfer the cash into the hands of the stockholders would necessitate a declaration of a dividend with the consequent tax to the recipient. Such dividend would be a charge against earnings. Consider what was accomplished here: The same results were obtained. Instead of the stockholders paying cash into the treasury of the corporation and subsequently receiving an equivalent amount back, the bonds were distributed directly to the stockholders on the same basis as if declared as a dividend. But to accomplish the actual transfer of the bonds to the stockholders without technically declaring a dividend, the plan of can- [fol. 115] celling the old stock was adopted. This distribution by the corporation of other property (the bonds) out of its earnings and accumulated profits as a result of the cancellation of its old stock, was thus made in such manner as to make the distribution and cancellation essentially equivalent to the distribution of a taxable dividend.

In connection with the application of Section 115(g) to this transaction, we need not inquire into motive. The "basic criterion" is the net effect of the distribution rather than the motives and plans of the taxpayer or his corporation: Smith v. United States, 121 F. 2d 692 (C. C. A. 3, 1941). Here, as pointed out above, the net effect of the distribution of the debenture bonds was to distribute to the petitioner a substantial segment of the previous earnings of the corporation: *cf.* Commissioner v. Estate of Bedford, supra.[13]

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[13] In the Bedford case, there was a *bona fide* "recapitalization-reorganization" which was effective to make tax free the receipt of stock by the taxpayer under Sec. 112 (b) (3), Sec. 112 (c) (1), 26 U. S. C. (1940 ed.), Sec. 112 (b) (3), Sec. 112 (c) (1). Obviously, this case is a much stronger one for imposing a tax than the "seemingly similar situation" where two corporations are involved and where the net

Petitioner, however, contends that the transaction here under consideration must be viewed as a whole. He asserts that it cannot be "split up" into two steps, (1) a cancellation of the old stock, and (2) a distribution of the debenture bonds.

[fol. 116] Following this reasoning, he insists the transaction was an exchange under Section 112 (b) (2) and Section 112 (c) (1) [14] and consequently taxable only as a capital gain under Section 117.[15] The full answer to this contention is found in Dobson v. Commissioner, 320 U. S. 489, 502 (1943), where the Supreme Court stated, "Whether an apparently integrated transaction shall be broken up into several separate steps and whether what apparently are several steps shall be synthesized into one whole transaction is frequently a necessary determination in deciding tax consequences. Where no statute or regulation controls, the Tax Court's selection of the course to follow is no more

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effect is to transfer earnings of one corporation to another and then to distribute out of the second corporation's assets. In that type of case, "Where one corporation acquired the assets of another corporation in a tax-free reorganization it is well settled that the earned surplus of the transferor becomes earned surplus of the transferee and is subject to taxation as a dividend on subsequent distribution to the stockholders of the transferee": Putnam v. United States, 149 F. 2d 721, 726 (C. C. A. 1, 1945), applying the doctrine of Commissioner v. Sansome, 60 F. 2d 931 (C. C. A. 2, 1932), certiorari denied 287 U. S. 667 (1932), which we followed in Corrigan v. Commissioner, 103 F. 2d 1010 (C. C. A. 3, 1939), certiorari denied 308 U. S. 576 (1939). For other cases in the long line following the Sansome decision, see f. n. 5 to Putnam v. United States, *supra*, at p. 726.

Furthermore, in determining whether there has been a "distribution of a taxable dividend", it is immaterial whether the distribution occurs after an exchange of stock and assets of two corporations as in Commissioner v. Sansome, *supra*, or whether the assets of one corporation only are involved: See Commissioner v. Estate of Bedford, *supra*, page 291.

[14] 26 U. S. C. (1940 ed.) Sec. 112 (b) (2), Sec. 112 (c) (1).

[15] 26 U. S. C. (1940 ed.) Sec. 117.

reviewable than any other question of fact." Consequently, we are required to view this transaction like the Tax Court did, as one involving a cancellation of old common stock followed by a distribution of the 20-year debenture bonds. And upon the reasoning already announced, we conclude that such distribution is taxable as a dividend under Section 115 (g): *cf.* Smith v. United States, 121 F. 2d 692 (C.C.A. 3, 1941).

The decision of the Tax Court is affirmed.

A true Copy: Teste:

_____, Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[fol. 117] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1945

No. 8947

J. ROBERT BAZLEY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Present: Biggs, McLaughlin and O'Connell, Circuit Judges.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

By the Court, John J. O'Connell, Circuit Judge.

January 8, 1946.

Endorsements: Order Affirming Decision of U. S. Tax Court. Received & Filed Jan. 8, 1946. Wm. P. Rowland, Clerk.

[fol. 118] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 8947

J. ROBERT BAZLEY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

MOTION TO EXTEND TIME FOR FILING PETITION FOR REHEARING

Now comes, the Petitioner, by his counsel, Henry S. Drinker and Frederick E. S. Morrison, and respectfully moves that the time within which Petition for Rehearing in this proceeding may be filed be extended thirty days to February 21, 1946. The opinion of the Court in this case was filed on January 8, 1946, so that the Petition for Rehearing under Rule 35 should be filed on or before January 23, 1946.

The pressure of income tax matters caused by the conjunction of preparing income tax returns for the clients of petitioner's counsel for filing on both January 15th and March 15th, has been and will be such that petitioner's counsel cannot properly prepare Petition for Rehearing in the time provided by the rules, and accordingly thirty days of additional time is respectfully requested.

(S.) Henry S. Drinker, Frederick E. S. Morrison,
1429 Walnut Street, Philadelphia 2, Pa.

Approved Goodrich, J. Jan. 19, 1946.

[fol. 119] [Endorsed:] In the United States Circuit Court of Appeals for the Third Circuit. No. 8947. J. Robert Bazley, Petitioner, v. Commissioner of Internal Revenue, Respondent. Motion to Extend Time for Filing Petition for Rehearing. Henry S. Drinker, Frederick E. S. Morrison.

[fol. 120] Table of Cases Cited

	Original
Bingham's Trust v. Commissioner, 65 S. Ct. 1232	6, 7
Commissioner v. Capento Securities Corp., 140 F. (2d) 382	4
Commissioner v. Gilmore's Estate, 130 F. (2) 791, 795	3
Dobson v. Commissioner, 320 U. S. 489	5
Doerschuck v. U. S., 274 Fed. 739	6
Gregory v. Helvering, 293 U. S. 465, 55 S. Ct. 266	2, 3, 4
Smith v. U. S., 121 F. (2d) 692	3
Wellhouse v. Commissioner, 3 T. C. 363	3

Statute Cited

Internal Revenue Code, 53 Stat. (Part 1); 26 U. S. C. A.:	
Section 111, 53 Stat. 37	1
Section 112(a), 53 Stat. 37	1
Section 112(b)(2), 53 Stat. 37	1
Section 112(b)(3), 53 Stat. 37	1
Section 112(c)(1), 53 Stat. 39	1, 5
Section 115, 53 Stat. 46	1
Section 115(a), 53 Stat. 46	8
Section 115(g), 53 Stat. 48	1, 7
Section 117, 53 Stat. 50	1, 5

[fol. 121] Petition for Rehearing

Comes now the above-named Petitioner, J. Robert Bazley, and presents this, his Petition for Rehearing of the above-entitled cause, and in support thereof, respectfully shows:

1. On January 8, 1946, this Court filed its opinion herein affirming the decision of the Tax Court of the United States that Petitioner, upon the receipt of $319,200. face amount of debenture bonds and 3,990 shares of new no-par common stock of J. Robert Bazley, Inc., in exchange for his 798 shares of $100 par value common stock of the same corporation, realized a taxable dividend as to such bonds under Section 115(g) of the Internal Revenue Code, and that Petitioner's income tax deficiency thereon amounted to $214,172.52. The Court denied Petitioner's contentions:

(1) That upon such exchange the bonds so received by him were not a dividend within any provision of Sec. 115 since the exchange was a tax-free "reorganization" (recap-

italization) exchange under the Code Provisions of Sec. 112(b)(3) OR, in the alternative:

(2) That even though the Tax Court found that such "exchange" needed but lacked, "a corporate business purpose", to constitute a "reorganization" as that term is used in Sec. 112(b)(3), it was nevertheless, an exchange (as Respondent admitted in both his Answer and Brief and as the Tax Court found) and hence fell squarely within the precise provisions of Secs. 111 and 112(a) and was taxable only to the extent as provided by Secs. 112(b)(2) and (c)(1) and limited to the capital gains tax rate as provided in Sec. 117.

[fol. 122] 2 Rehearing is sought on the following grounds:

I

On the First Contention—whether a corporate business purpose is essential to a tax-free "reorganization":

(1) The Tax Court did not find that the "exchange" was in any sense a "sham" or ineffective to result in the valid issue of the new stock and debentures "in exchange for" the old stock. On the contrary, it found that the new securities were validly issued and are permanently outstanding in the hands of the holders, whose proportionate interests in the Corporation are precisely the same as prior thereto. On p. 28 of his brief in this Court, the Commissioner says:

> "It is not disputed that the new common stock and debentures issued in the recapitalization were real and gave the recipients the rights in the corporation which they purported to do as taxpayer argues (Br. 36). But the question here is whether what was done was inspired by purposes having a substantial relation to the Corporation's business, so that the recapitalization may be given effect for tax purposes."

(2) The Tax Court's conclusion that a corporate business objective was necessary as distinguished from one beneficial only to the stockholders was not based on a construction by it of the statute or of any document, but on its interpretation of the decision of the Supreme Court in the *Gregory* case. This involved the clearest and purest imaginable question of law.

(3) The phrase in the *Gregory* case which the Tax Court has construed to mean a legitimate corporate business purpose was a business *or* corporate purpose. It is submitted that if the Supreme Court had intended to draw a distinction between a purpose of the corporation and one [fol. 123] of its stockholders, it would have said "corporate business purpose", or "purpose of the corporate business". The Tax Court's construction of the phrase ignores the Supreme Court's use of the disjunctive "or", and, for that matter, the words "business or" since a corporation can have no purpose except the furtherance of its business for the benefit of its stockholders.

(4) In its decision, this Court expressly stated that the test was not the taxpayer's motive, but the result attained. (See also *Smith v. U. S.*, 121 F. 2d 692.) Irrespective of the genuineness of the stockholder's motive in obtaining a greater number of shares of lesser value per share for actual sale by him to key employees, the corporation, by means of the recapitalization, created shares which would be available for such sale by the stockholders when this seemed advisable, a result of obvious advantage to the corporation.

(5) The distinction between a legitimate *corporate* business purpose and one benefitting the *stockholders* has not, it is submitted, been made consistently by the Tax Court, since the decision in the *Gregory* case, as intimated at the bottom of page 6 of this Court's printed opinion.

This supposed distinction was invented by Judge Disney of the Tax Court in a dictum in the *Wellhouse* case, 3 T. C. 363, Feb. 28, 1944, as an interpretation of a dictum in the *Gregory* case more than nine years before. It was first actually applied by the Tax Court in the decision of the case at bar. The Treasury regulations referred to by this Court do not, it is submitted, refer to the necessity of a *corporate* business exigency, but merely to a business exigency, which means that the transaction is a genuine one, and effected for reasons other than avoidance of a tax which is "imminent".

Nor did this Court in the *Gilmore* case (130 F. 2d) refer to the necessity of a *corporate* business purpose, but merely, [fol. 124] on page 795 to a "legitimate business result", a "legitimate business object", and a "genuine transaction"; on page 797 to "a reorganization in reality"; in note 13, to

"business exigency"; in note 14 to "legitimate business purposes". The word "corporate" was inserted by the Tax Court.

Similarly in *Carpento*, 140 F. (2d) 382, the Court does not refer to a "corporate business purpose" but, quoting the *Gregory* case, to a "business *or* corporate purpose" (page 385) and to "an ordinary business transaction."

(6) It is difficult to believe that this Court, in supporting the Tax Court's *construction* of the Supreme Court's reference to a business *or* corporate purpose as meaning "corporate business purpose" can have taken into consideration the legal complications which must necessarily follow, and the litigation which will result, in future cases involving recapitalizations. While in some of these cases, it will doubtless be possible to point to a more or less apparent corporate advantage, in the great majority of cases changes in the capitalization of a corporation are in reality advantageous only to the stockholders. For example, is there a demonstrable corporate advantage in the exchange of $100,000. par value 4% preferred stock and $100,000. par value of common stock for $80,000. par value 5% preferred and 1250 shares of no par common? If the rule here established be followed, it will set up a test of the validity of scores of recapitalizations so vague as to be wholly unpredictable, resulting in conclusion based on no substantial differences, in cases, all of which result in no change of continuity in control and in no present realization of actual gain to the stockholders, but merely in a change in the form of the security. Such a radical departure from long existing practice and legal standards should, it is submitted, be effected only by a prospective amendment to the law by Congress, or, at least, by the Supreme Court's own construction of its decision.

[fol. 125] II

On the second point—, that the admitted "exchange," if not tax-free, in any event was solely an "exchange" of stock for "stock and other property," under Sec. 112 (c) (1) and taxable under Section 117:

(1) Under *Dobson v. Commissioner*, 320 U. S. 489, it is clear that the Appellate Federal Courts are bound by the Tax Court's findings as to what are the primary facts. As stated in the quotation by this Court at the end of its

present opinion, such conclusive findings of primary facts include one as to whether an exchange of securities constitutes one integrated transaction or several separate steps.

(2) The Tax Court found expressly that the transaction in question was an *exchange* of the old common stock for the new common stock *and* the debenture bonds. In describing the plan of reorganization, it said:

> "The corporation was to issue *in exchange for the old stock*, the new stock *and* the debenture bonds * * *" (pp. 92a-93a).
>
> "*Pursuant to the plan*, the stockholders on March 16, 1939, delivered their 1,000 shares of common stock to the corporation and received from the corporation the 5,000 shares of its new common stock and debenture bonds in the aggregate principal amount of $400,000." (93a-94a) (emphasis supplied).

Paragraphs (5) and (6) of subdivision V of respondent's answer expressly admits (12a-13a) that the transaction was an *exchange* of the new stock *and* the bonds for the old stock.

At the end of the first paragraph of its opinion the Tax Court again characterizes the transaction as "*an exchange of stock for stock and securities* of the same corporation." [fol. 126] The Tax Court also found the facts in the stipulation (90a), paragraphs 10, 12 and 18 of which (16a-18a) stated that the shares of new common stock and the debenture bonds were issued by the company *in exchange* for the shares of $100 par stock previously outstanding.

(3) Under *Bingham's Trust v. Commissioner*, 65 S. Ct. 1232 (June 25, 1945) it is both the function and duty of the Federal Appellate Courts to correct the Tax Court's erroneous application of the law *to the facts found by that Court*.

(4) The Appellate Court can no more revise the Tax Court's primary findings of fact in order to *sustain* its legal conclusions than it can revise such primary findings in order to *upset* them.

(5) If the Tax Court had found from the evidence that the transaction *did not in fact* consist in an exchange of the old stock for new stock *and* bonds, but in fact consisted in an exchange of the old stock for the new stock, and that

the "distribution" of the bonds was in fact a separate transaction and not part of the exchange, this would be a wholly different case.[1] The Tax Court, however, did not so find, but found expressly that the issuance of the bonds was part of the unitary transaction which constituted the exchange.

(6) When this Court, at the end of its Opinion, states that the Tax Court viewed this transaction "as one involving a cancellation of old common stock *followed* by[2] a *distri-* [fol. 127] *bution* of the 20-year debenture bonds," this Court, it is respectfully submitted, did precisely what it states so clearly that this Court has no right and power to do,—it altered the Tax Court's own express finding of an essential fact in an endeavor to make such finding fit the legal conclusion which this Court sought to sustain.

(7) In the *Bingham* case, supra, the Supreme Court said (65 S. Ct. 1232, 1236):

> "Since our decision in the Dobson case we have frequently reexamined, as matters of law, determinations of the Tax Court of the meaning of the words of a statute as applied to the facts found by that court. A question of law is not any the less such because the Tax Court's decision of it is right rather than wrong."

Similarly, a finding of fact by the Tax Court is not any the less such because it does not support the legal con-

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[1] In *Doerschuck v. U. S.*, 274 Fed. 739, which involved the old Act of 1916, the bonds in question were distributed pro-rata to the stockholders out of the company's surplus earned since March 1, 1913. There was no "recapitalization" tax-free or otherwise, nor any exchange for new securities. The reorganization provisions were not included in the Act until 1918. The only question argued was whether the bonds were substantially equivalent to preferred stock, and the decision was that they were not.

[2] See also p. 7 of the Opinion where this Court speaks of the "distribution" of the debenture bonds as "following" the cancellation of the old common stock. The word "distribution," which implies a dividend, was not used by the Tax Court. It found that the bonds were issued *with* the new stock *in exchange* for the old common stock, a single transaction.

clusion at which the Tax Court or the Appellate Court would arrive.

(8) While the Tax Court states at the end of the first two passages quoted under (2) above, that the old stock was "cancelled by the corporation" after the exchange, under the primary facts found by the Tax Court, any such cancellation of the old stock *after* the exchange would, as a matter of law, have consisted merely of a physical mutilation of the old certificates. As a result of the exchange there was no reduction in the capital stock of the Corporation, either that authorized or that outstanding. In fact the capital stock was increased from $100,000 to $300,000.

(9) Admittedly the old stock was not "redeemed" by the corporation. It was doubtless for this reason,—recognizing that Section 115 (g) was not designed to cover and does not cover cases involving a recapitalization of a corporation's entire capital structure in a reorganization,—[fol. 128] that the Commissioner, in his brief in this Court (p. 30) repudiated the Tax Court's legal conclusion that this case came under that Section, and relied on Section 115(a), despite the Commissioner's admission and Tax Court's express finding that the debenture bonds were issued with the new stock, in exchange for the old stock.

Respectfully submitted, Henry S. Drinker, Frederick E. S. Morrison, Calvin H. Rankin, 1429 Walnut St., Philadelphia 2, Pa., for Petitioner.

Drinker, Biddle & Reath.

I certify that the foregoing petition is presented in good faith and not for delay,

Henry S. Drinker.

[fol. 129] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1945

No. 8947

J. ROBERT BAZLEY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

SUR PETITION FOR REHEARING

Present: Biggs, Maris, Goodrich, McLaughlin and O'Connell, Circuit Judges.

And Now, to wit, Feb. 14, 1946, after due consideration, the petition for rehearing in the above-entitled case is hereby granted, the rehearing to be before the court en banc.

Philadelphia, —— —, ——.

John J. O'Connell, Circuit Judge.

Endorsements: Order Granting Petition for Rehearing. Received & Filed, Feb. 14, 1946. Wm. P. Rowland, Clerk.

[fol. 130] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1945

No. 8947

J. ROBERT BAZLEY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER

Present: Biggs, Maris, Goodrich, McLaughlin and O'Connell, Circuit Judges.

Now, to wit, this 8th day of April, 1946, rehearing in the above entitled case having been granted by the court en banc the 5th day of March 1946, It Is Hereby Ordered and

Directed that the opinion filed as of January 8, 1946, be and the same is hereby withdrawn.

By the Court, Jno. J. O'Connell, Circuit Judge.

Endorsements: Order Withdrawing Opinion. Filed Jan. 8, 1946. Received & Filed Apr. 8, 1946. Wm. P. Rowland, Clerk.

[fol. 131] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1945

No. 8947

J. ROBERT BAZLEY, Petitioner;

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the Decision of the Tax Court of the United States

Argued November 20, 1945

Reargued March 5, 1946

Before Biggs, Maris, Goodrich, McLaughlin and O'Connell, Circuit Judges

OPINION OF THE COURT—Filed April 16, 1946

By O'CONNELL, Circuit Judge:

This is a petition to review the decision of the Tax Court sustaining an income tax deficiency assessed against J. Robert Bazley.[1]

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[1] The Tax Court upheld the Commissioner in assessing deficiencies against both J. Robert Bazley and Alice H. Bazley. By stipulation approved this judgment is controlling in the case of Alice H. Bazley. This case was originally argued before Biggs, McLaughlin and O'Connell, Circuit Judges. An opinion of the court, per O'Connell, Circuit Judge, was filed on January 8, 1946. Petition for reargument was granted. Reargument was had before the court en banc. Opinion of January 8, 1946, has been withdrawn and this supersedes it.

[fol. 132] Mr. and Mrs. J. Robert Bazley owned all but one share of J. Robert Bazley, Inc. As of February 1, 1939, the corporation had accumulated an earned surplus of $853,783.82. On March 16, 1939, the corporation distributed to Mr. and Mrs. Bazley and the one qualifying shareholder, in amounts proportionate to their shareholdings, $400,000 in twenty year debenture bonds.[2] A corresponding reduction in earned surplus was made on the books of the corporation. Is this $400,000 in twenty year debenture bonds, callable at the option of the obligor, freely marketable and admittedly worth their face value, taxable as ordinary income to the distributees? The Commissioner assessed a deficiency against the Bazleys for the year 1939 on the ground that the $400,000 in bonds represented taxable income in the hands of the recipients. The Tax Court upheld the Commissioner, concluding that the distribution of the bonds "was essentially equivalent to the declaration of a taxable dividend." Internal Revenue Code, Section 115 (g).[3] We are asked to reverse the Tax Court, chiefly on the assertion that the $400,000 in bonds are exempt from taxation because they were distributed in pursuance of a plan of reorganization of J. Robert Bazley, Inc., within the meaning of Section 112 of the Code.

Shortly prior to February 1, 1939, J. Robert Bazley, Inc., was engaged in general heavy contracting business with most of its operations consisting of coal mining by the open pit method. As previously indicated, the corporation's stock was owned by J. Robert Bazley, Alice H. Bazley, his wife, and Alfred Day, all of whom constituted the board [fol. 133] of directors. On February 16, 1939, these three people as owners of the outstanding capital stock of the corporation held a special meeting pursuant to resolutions adopted by themselves as the board of directors on February 6, 1939, and formally approved a proposed plan of reorganization. Resolutions authorizing the necessary corporate action for consummation of this plan were passed. On March 6, 1939, the Commonwealth of Pennsylvania ap-

[2] J. Robert Bazley received $319,200 in debenture bonds, Alice H. Bazley, his wife, received $80,400 in debenture bonds, and Alfred Day received $400 in debenture bonds.

[3] 26 U. S. C. (1940 ed.) Sec. 115 (g); 26 U. S. C. A. Sec. 115 (g).

proved the amendments to the company's Articles of Incorporation increasing the authorized common stock.

The reorganization is reflected in the table set forth below which indicates stock ownership and capitalization of the corporation before and after the occurrence of the transaction under scrutiny here.

Name	OLD Number of Shares	NEW Number of Shares	NEW Debenture Principal Amount
J. Robert Bazley	798	3,990	$319,200.00
Alice H. Bazley	201	1,005	80,400.00
Alfred Day	1	5	400.00
Total	1,000	5,000	$400,000.00

CAPITAL STRUCTURE OF CORPORATION

February 1, 1939 (Before proposed reorganization)	
1,000 shares common stock par value of $100 per share	$100,000.00
Earned Surplus	855,783.82
	$955,783.82
March 16, 1939 (After reorganization)	
Outstanding Debenture Bonds	$400,000.00
[fol. 134] 5,000 shares common stock without nominal or par value, the stated capital applicable to which is	300,000.00
Earned Surplus	255,783.82
	$955,783.82

On March 16, 1939, the stockholders delivered their 1,000 shares of old common stock to the corporation and received from the corporation the 5,000 shares of the new common stock[4] and debenture bonds in the aggregate prin-

[4] No attempt was made to tax receipt of the common stock, in whole or in part. *Cf. Helvering* v. *Griffiths*, 318 U. S. 371 (1943).

cipal amount of $400,000. The old common stock was cancelled by the corporation.

Whether a corporation has cancelled its stock at such time and in such manner as to make the distribution and cancellation in whole or in part essentially equivalent to the distribution of a taxable dividend is a question of fact: Brown v. Commissioner, 79 F. 2d 73 (C. C. A. 3, 1935); Commissioner v. Champion, 78 F. 2d 513 (C. C. A. 6, 1935); Commissioner v. Babson, 70 F. 2d 304 (C. C. A. 7, 1934); Randolph v. Commissioner, 76 F. 2d 472 (C. C. A. 8, 1935); Hirsch v. Commissioner, 124 F. 2d 24 (C. C. A. 9, 1941). Consequently, we are powerless to disturb the Tax Court's determination of such a factual question if substantial evidence to support it exists: Helvering v. Kehoe, 309 U. S. 277 (1940). Nor will we controvert the Tax Court's holding by "treating as questions of law what really are disputes over accounting": Dobson v. Commissioner, 320 U. S. 489, 499 (1943). Indeed, such determinations seem to fall clearly within the *Dobson* rule: *Cf.* The John Kelley Co. v. Commissioner; Talbot Mills v. Commissioner, U. S. Sup. Ct., January 7, 1946.

In any event, as we view the record in this case, we believe the Tax Court, applying the correct criterion, reached the correct conclusion. Actually, no "sole decisive" [fol. 135] test for the application of Section 115 (g)[5] has been laid down: Flanagan v. Helvering, 116 F. 2d 937 (App. D. C. 1940), per Vinson, J. The history of Section 115(g), beginning with the Act of 1926, throws some light on the desired objective of Congress in passing such legislation In the House, Senate and Conference Reports[6] an illustration of the type of situation intended to be covered by this section was given thus: Suppose "* * * the case of two

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[5] 26 U. S. C. (1940 ed.) Sec. 115(g); 26 U. S. C. A. Sec. 115(g).

[6] H. Rep. No. 1, 69th Cong., 1st Sess. p. 5; S. Rep. No. 52, 69th Cong., 1st Sess. p. 15; H. Conference Rep. No 356, 69th Cong., 1st Sess. p. 30.

As pointed out in fn. 3 of Flanagan v. Helvering, *supra*, the illustration was made in connection with the Act of 1926, Sec. 201(g), 44 Stat. 11, 26 U. S. C. A., Int. Rev. Acts, p. 147. In relevant portion this is identical with the corresponding section of the 1939 Revenue Act, 26 U. S. C. (1940 ed.) Sec. 115(g).

men holding practically the entire stock of a corporation for which each paid $50,000. The corporation having accumulated a surplus of $50,000 above its cash capital, buys from the stockholders for cash one-half the stock held by them and cancels it, and the payment is non-taxable because it is a partial redemption of stock. To change this result and make it taxable [§ 115](g) was written and incorporated into the law."[7]

We see no real distinction between a case where the corporation pays cash for its outstanding stock and where the corporation pays in the form of debenture bonds for its old stock: see Doerschuck v. United States, 274 Fed. 739 (E. D. N. Y., 1921). In each case the application of Section 115(g) to the transaction under scrutiny depends on the particular facts: McGuire v. Commissioner, 84 F. 2d 431 (C. C. A 7, 1936); certiorari denied, 299 U. S. 591 (1936).

Under Section 115 (a)[8] a distribution out of accumulated earnings and profits is a "dividend." "Recapitaliza-[fol. 136] tion does not alter the 'effect' ": Commissioner v. Estate of Bedford, 325 U. S. 283, 292 (1945). The net worth of the corporation, i.e., the value of the stock in the hands of the stockholders, prior to the reorganization, was $955,783.82. This value, after reorganization, was $555,783.82. Clearly, the corporation has thus distributed $400,000 out of accumulated earnings and profits. The

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[7] For an example of the applicability of the illustration to an actual case, see Hyman v. Helvering, 71 F. 2d 342 (App. D. C., 1934); certiorari denied, 293 U. S. 570 (1934).

[8] 26 U. S. C. (1940 ed.) Sec. 115(a); 26 U. S. C. A. Sec. 115(a):

"(a). Definition of Dividend.—The term 'dividend' when used in this chapter (except in section 203(a)(3) and section 207(c)(1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913; or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made."

face and market value of the bonds is admittedly $400,000. By their distribution to the stockholders, the corporation effectively consumed that much of the earned surplus which would otherwise be available for declaration of subsequent dividends. The Bazleys admit this.

To issue bonds, it would not have been necessary to adjust the value of the capital stock ($100,000) on the books of the corporation. Normally, the bonds would have been sold for cash, in which event no charge would have been made against earnings. But had the normal procedure been followed, to transfer the cash into the hands of the stockholders would necessitate a declaration of a dividend with the obvious consequent tax to the recipient. Such dividend would be a charge against earnings. Consider what was accomplished here. The same results were obtained. Instead of the stockholders paying cash into the treasury of the corporation and subsequently receiving an equivalent amount back, the bonds were distributed directly to the stockholders on the same basis as if declared as a dividend. But to accomplish the actual transfer of the bonds to the stockholders without technically declaring a dividend, the plan of cancelling the old stock was adopted. This distribution by the corporation of other property (the [fol. 137] bonds) out of its earnings and accumulated profits as a result of the cancellation of its old stock thus occurred at such time and in such manner as to make the distribution and cancellation essentially equivalent to the distribution of a taxable dividend.

In connection with the application of Section 115(g) to this transaction, we need not inquire into motive. The "basic criterion" is the net effect of the distribution rather than the motives and plans of the taxpayer or his corporation: Smith v. United States, 121 F. 2d 692 (C. C. A. 3, 1941). Here, as pointed out above, the net effect of the distribution of the debenture bonds was to distribute to the petitioner a substantial segment of the previous earnings of the corporation: *Cf.* Commissioner v. Estate of Bedford, *supra*.[3]

[3] In the *Bedford* case, there was a *bona fide* "recapitalization-reorganization" which was effective to make tax-free the receipt of stock by the taxpayer under 26 U. S. C. (1940 ed.), Sec. 112(b)(3), Sec 112(c)(1), 26 U. S. C. A. Sec. 112 (b)(3), Sec. 112 (c)(1). Obviously this case is a much

The Tax Court's factual conclusion that this was a distribution out of earnings and profits, essentially equivalent to the distribution of a taxable dividend, disposes of the petitioner's contention that at the most he is taxable only at the capital gains rate. Sections 117, 112(b)(2) and [fol. 138] 112(c)(1).[10] These sections must be read and applied in conjunction with Section 115[11] which governs distributions and defines "dividend" as "any distribution made by a corporation to its shareholders, whether in money or other property * * * out of its earnings or profits accumulated after February 28, 1913, or * * * out of the earnings or profits of the taxable year * * *." Section 112 may not be used as a device for evading taxes Congress intended to impose. Commissioner v. Fisher, U. S. Sup. Ct., March 11, 1946.

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stronger one for imposing a tax than the "seemingly similar situation" where two corporations are involved and where the net effect is to transfer earnings of one corporation to another and then to distribute out of the second corporation's assets. In that type of case, "Where one corporation acquired the assets of another corporation in a tax free reorganization it is well settled that the earned surplus of the transferor becomes earned surplus of the transferee and is subject to taxation as a dividend on subsequent distribution to the stockholders of the transferee": Putnam v. United States, 149 F. 2d 721, 726 (C. C. A. 1, 1945), applying the doctrine of Commissioner v. Sansome, 60 F. 2d 931 (C. C. A. 2, 1932), certiorari denied 287 U. S. 667 (1932), which we followed in Corrigan v. Commissioner, 103 F. 2d 1010 (C. C. A. 3, 1939), certiorari denied 308 U. S. 576 (1939). For other cases in the long time following the *Sansome* decision, see f.n. 5 to Putnam v. United States, *supra* at p. 726.

Furthermore, in determining whether there has been a "distribution of a taxable dividend," it is immaterial whether the distribution occurs after an exchange of stock and assets of two corporations as in Commissioner v. Sansome, *supra*, or whether the assets of one corporation only are invoved: See Commissioner v. Estate of Bedford, *supra* at p. 291.

[10] 26 U. S. C. (1940 ed.) Sec. 117, 112(b)(2) and 412(c)(1); 26 U. S. C. A. Sec. 117, 112(b)(2) and 112(c)(1).

[11] 26 U. S. C. (1940 ed.) Sec. 115; 26 U. S. C. A. Sec. 115.

But, it is argued on behalf of the taxpayer that no tax whatsoever may be imposed on the $400,000 in bonds because they were received pursuant to a plan of reorganization of J. Robert Bazley, Inc. Admittedly, there was a "recapitalization" of J. Robert Bazley, Inc., in the corporate accounting sense. That, however, would not result in a tax exemption. It takes more than a mere literal matching of corporate actions with the words of Section 112 to qualify for tax freedom under the reorganization provisions of the Code: see Commissioner v. Gilmore's Estate, 130 F. 2d 791, 794 (C. C. A. 3, 1942). Reference to legislative history reveals that ten years' experience with the exchange and reorganization provisions of the Code led to a strong Congressional movement to excise them completely from the Revenue Act of 1934. They were retained in substantially their present form in reliance upon the prior practice of the courts to "interpret" their provisions so as to prevent escape from taxation in situations where Congress meant to grant no such exemption.[12] In the view of the then

[12] During the debate on the 1934 Revenue Act, the entire question of the retention of the reorganization sections of the Act was under serious consideration. On December 4, 1933, a subcommittee of the House Ways and Means Committee proposed the abolition of the exchange and reorganization provisions of Section 112. This was rejected. In its final form, the Revenue Act of 1934 contained what are substantially the same provisions of the present Act.

In the Report accompanying the submission of the Revenue Act of 1934 (H. R. No. 704, 73d Cong., Second Session), Chairman Doughton of the Committee stated, "The reorganization provisions have been in effect for many years, having been adopted in substantially their present form in 1924. They state in detail how each step of a reorganization should be treated for tax purposes. The policy was adopted of permitting reorganizations to take a wide variety of forms, without income-tax liability. As a result, astute lawyers frequently attempted, especially during the prosperous years, to take advantage of these provisions by arranging in the technical form of a reorganization, within the statutory definition, what were really sales. A number of these cases have been carried to the courts, with results on the whole favorable to the Government. The courts have shown a commendable tendency to look through the mere form of the transaction into its substance."

[fol. 139] Chairman of the House Ways and Means Committee, the reorganization sections were retained in the Code so that "legitimate reorganizations, required in order to strengthen the financial condition of the corporation will be permitted."[13] Since 1934, administrative interpretation of the reorganization section has limited its benefits to readjustments "as are required by business exigencies" and which are "undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization."[14] Added sanction is given to the administrative interpretation by the re-enactment of the statute without disapproval of the regulations thereunder: United States v. Dakota-Montana Oil Co., 288 U. S. 459, 466 (1933); Helvering v. Winmill, 305 U. S. 79, 83 (1938); Helvering v. Griffiths, 318 U. S. 371, 395, 396 (1943); Commissioner v. [redacted]eler, 324 U. S. 542, 547, f.n. 10 (1945).

The Tax Court found nothing in the calling in of old common stock, issuance and distribution of new common stock, issuance and distribution of $400,000 in bonds which was required to strengthen the financial condition of the corporation. In considering the readjustments brought [fol. 140] about by the so-called reorganization, it did not conclude that this one was required by business exigencies or was undertaken for reasons germane to the continuance of J. Robert Bazley, Inc. It did find that, "There was no legitimate purpose of the corporate business of J. Robert Bazley, Inc., in the issuance and distribution to the stockholders of $400,000 in debenture bonds." To be sure, the Bazleys advanced a number of reasons which, they said, motivated the financial transaction as a result of which they obtained the bonds.[15] None of these in which the Tax

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[13] See Report of Chairman Doughton of the House Ways and Means Committee, *supra*, f.n. 12.

[14] Treasury Regulations 86, under Revenue Act of 1934, Arts. 112 (g) 1-2. These have remained unchanged with the passage of succeeding revenue acts.

[15] They claimed the following reasons motivated the "reorganization": (1) the stockholders, by obtaining debenture bonds for their stock, would receive a more readily marketable and less fluctuating security in case it would become necessary for the estate of a deceased shareholder to liquidate his investment to meet inheritance taxes or for

Court put credence, however, were even remotely required by "business exigencies" or were "germane to the continuance" of J. Robert Bazley, Inc. To reverse the Tax Court in this case, we would have to hold the Treasury Regulations invalid. There is nothing unreasonable about the regulation. It is a valid exercise of the rule making power. Commissioner v. Wheeler, *supra*.

Indeed, even prior to the 1934 Act and the Regulations thereunder, the Second Circuit demonstrated that literal [fol. 141] compliance with the reorganization sections of the Code is insufficient to qualify for freedom from taxation if a particular situation would otherwise have called for a tax: Helvering v. Gregory, 69 F. 2d 809 (C. C. A. 2, March 19, 1934), interpreting Section 112 of the Revenue Act of 1928. Judge Learned Hand there considered the actions taken by the corporation and the shareholders in effecting a literal reorganization by forming a new corporation to which certain property was transferred and ultimately dis-

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other purposes; (2) the bonds could be sold without reducing the Bazley family's stock control of the corporation; (3) the contemplated entry into the hazardous business of road construction made it desirable for stockholders to possess bonds in order to be in a position at least equal to general creditors in the event of insolvency; (4) the value of the corporation's plant and equipment ($719,782.41 as of April 30, 1939) was large as compared with its capitalization of $100,000, and since such equipment had been purchased by using funds acquired through accumulation of $855,783.07 of earnings and profits, it was deemed advisable to reflect a dedication of these earnings to corporate use by reducing surplus available for dividends and transferring a part thereof to capital stock and a part to long-term debt represented by the 20-year bonds. Two additional motives advanced by the petitioner as reasons for the questioned transaction were (a) to provide stock of a type available for sale to the company's key employees and (b) to reduce the company's taxable income by $24,000 through the interest payments on the debenture bonds. The majority of the Tax Court refused to accept these two purposes as having existed in fact and, on the whole record, concluded that no legitimate corporate business purpose existed for the recapitalization.

tributed to the taxpayer. He remarked, at p. 811, "All these steps were real, and their only defect was that they were not what the statute means by a 'reorganization', because the transactions were no part of the conduct of the business of either or both companies; so viewed they were a sham, though all the proceedings had their usual effect." See Gregory v. Helvering, 293 U. S. 465, 469 (1935). So, too, in the present case, the Tax Court has found that there was in fact no legitimate purpose of the corporate business of J. Robert Bazley, Inc., in the issuance and distribution to the stockholders of $400,000 in debenture bonds. Considering actions and results, as we must in the doubtful realm of reorganizational exemptions,[16] we have already demonstrated that $400,000 was siphoned out of accumulated corporate earnings and distributed to the Bazleys and the lone qualifying shareholder in the form of debenture bonds. Congress obviously did not intend to grant a tax exemption in such a situation merely because, *qua* corporate accounting, there was a "recapitalization" and thus a "reorganization": *cf.* Commissioner v. Wheeler, *supra.* Clearly, a reversal of the Tax Court's holding would permit the use of the Section 112 exemption as a device for evading taxes Congress intended to impose under Section 115: *cf.* Commissioner v. Fisher, *supra.* In its last analysis, the [fol. 142] "recapitalization-reorganization" here under consideration accomplished nothing other than a distribution to the Bazleys and Day which consumed a large portion of the corporation's earned surplus otherwise available for the subsequent declaration of dividends. This result was one which, whatever the motives of the Bazleys may have been, cannot have the effect desired by the recipients of freedom from tax liability. For tax purposes, it stands as any other distribution under Section 115. The distributees must therefore pay income taxes on the bonds received to the extent of their face value.

Affirmed.

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[16] One claiming an exemption from a tax has the burden of sustaining his claim and the tendency is to disallow the claim where doubts are nicely balanced: see Trotter v. Tennessee, 290 U. S. 354, 356 (1933); *cf.* Lloyd v. Commissioner, C. C. A. 3, March 4, 1946.

MARIS and GOODRICH, *Circuit Judges*, dissenting:

The critical question in this case is, we think, one of law and one upon which this Court has an obligation to exercise its own judgment when the decision of the Tax Court is brought here for review. That question is whether a corporate reorganization, in order to be tax free, must be one conducted for a "corporate business purpose" of the corporation as distinguished from serving a proper business interest of the shareholders.

That this question is squarely presented there can be no doubt. The Tax Court's findings of fact with regard to the reasons for the transaction here in question are as follows:

> "Reasons for adopting the transaction hereinafter described involving the issuance of additional common stock and of debenture bonds were that the original shareholders, by obtaining debenture bonds for their stockholdings, would receive a security which was much less fluctuating and more readily marketable, particularly in case it was necessary for a deceased shareholder's estate to liquidate his investment in the corporation in order to meet inheritance taxes or for [fol. 143] other purposes, and that if it became necessary to sell some portion of their investment in the corporation the debenture bonds could be sold without reducing the Bazley family stock control of the corporation; that the contemplated entry into the hazardous road building business make it desirable to put the original stockholders in possession of bonds which would place them in a position of sharing alike with creditors to the extent of the debentures instead of ranking after creditors if the business did not succeed; that as of February, 1939, the corporation had plant and equipment of a value ($719,782.41 as of April 30, 1939), which was large in relation to the $100,000 par value of the capital stock outstanding, and since the equipment had been purchased by the use of funds acquired through the accumulation of $855,783.07 of earnings and profits since the organization of the business in 1930, it was thought advisable to reflect a more permanent dedication to corporate use of these earnings by reducing the surplus available for dividends and transferring a portion thereof to the capital stock

account and another portion to the long-term debt represented by 20-year debenture bonds."

An additional finding of fact is made as to the relation of the purpose and the corporate business. It reads as follows:

"There was no legitimate purpose of the corporate business of J. Robert Bazley, Inc., in the issuance and distribution to the stockholders of $400,000 in debenture bonds."

The significance of these findings of fact is pointed up by the discussion of the Tax Court when it says:

"Such objectives as to create a security more desirable for the stockholders as being less fluctuating in value, more regular and certain in its income, easier to market for inheritance tax payments and furnishing greater safety against claims of corporate creditors are easily understandable from the standpoint of the stockholders. They furnish persuasive reasons [fol. 144] why the stockholders wanted to change the form of their investment. But, as we have said, a desire to encompass such an exchange without occasioning the tax consequences usually attendant upon those transactions would not supply the necessary purpose as a business or corporate object."

We accept the Tax Court's findings of fact. We also, now that we understand we are so to do, accept its conclusion when it applies its facts to a correct rule of law regardless of whether we, in a particular instance, would have reached the same conclusion or not. But if we believe the legal criterion used by the Tax Court is incorrect it is our duty so to say and to send the case back for appropriate proceedings under the application of what we deem the correct criterion.

We think that the criterion here making a distinction between "corporate" and "shareholder" purpose is incorrect. The foundation for it is supposed to be Gregory v. Helvering, 293 U. S. 465 (1935). That case involved the formation of a dummy corporation which did no business otherwise than to participate in a transfer which the taxpayer was seeking to effect without tax liability. What we

had was a sale masquerading as a reorganization. The court struck through the sham.

To expand that decision into a rule of law such as is now contended for is to push it beyond anything which we think the court could have had in mind. Nor do we think the expansion is one which a reasonable growth beyond Gregory v. Helvering would call for. We have long since passed the place in our thinking where we view the corporation as "an artificial being, invisible, intangible and existing only in contemplation of law". We think of it as a device that shareholders use to carry on their business as a group. A corporation does not have purposes apart from its shareholders. Shareholders, of course, may have conflicting interests among themselves with regard to the conduct of their common enterprise. They may fight with [fol. 145] each other, perhaps, in order to elect A instead of B to the directorship of their company. And, of course, aside from their interest in the common enterprise, called their corporation, they have interests as varied as the hopes and desires of human beings. But when we talk about the interest of shareholders in connection with the business enterprise and have a finding of fact that such and such a thing was done and that it was to the shareholders' business advantage, speaking of them as a group, we do not find substance in a distinction between the business advantages of the shareholders with respect to the corporation or the business advantages of the corporation itself.

Furthermore, this very thing concerned with here, reorganization, is a matter in which shareholders directly participate. The day to day business of the corporation is done by its officers, directors, employees. But a realignment of the interests in the enterprise through reorganization must come, under every corporation law we know of, through vote of the shareholders. In such circumstances it is as a practical matter impossible to separate as to the very transaction involved, a "shareholder's" from a "corporate" interest.

We think the distinction attempted coming, as it does, quite a number of years after Gregory v. Helvering, is one not established by that decision, the statute, nor the regulations. If reorganization provisions contain too many avenues of escape for taxes which ought to be collected the Congress can close those avenues by appropriate legislation

which can be so framed and defined as to leave the way clear to what it deems are business transactions in which no gain or loss should be recognized. We do not think it should be by judicial decision which establishes the exceedingly vague criterion as to whether a given transaction was to the interest of the shareholder as distinguished from the interest of the corporation in which he holds shares of stock.

[fol. 146] The gloss here sought to be placed upon those provisions of Section 112 of the Internal Revenue Code which render non-taxable the exchange of certain securities in connection with corporate reorganizations, can only be justified upon the assumption that all reorganizations which are put through by stockholders solely to promote their own business purposes must necessarily involve the motive of tax avoidance. Only upon this assumption can the principle of Gregory v. Helvering be applicable. But this assumption is quite unsound as the facts of the case before us demonstrate. And even clearer cases can readily be brought to mind. Suppose a case in which the common shareholders arrange for the reclassification of a part of their holdings as non-voting stock in order that they may sell it or give it away without endangering their voting control. This would be a perfectly proper business purpose of the stockholders involving not a trace of tax avoidance but it would not benefit the business of the corporation as such. We do not think that there is any authority for the proposition that such a recapitalization would not be within both the letter and the spirit of Section 112.

A true Copy: Teste:

——, Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[fol. 147] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1945

No. 8947

J. ROBERT BAZLEY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Present: Biggs, Maris, Goodrich, McLaughlin and O'Connell, Circuit Judges.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

By the Court, John J. O'Connell, Circuit Judge.

April 16, 1946.

Endorsements: Order Affirming Decision of Tax Court. Received & Filed April 16, 1946. Wm. P. Rowland, Clerk.

[fol. 148] UNITED STATES OF AMERICA,
Eastern District of Pennsylvania,
Third Judicial Circuit, Set.:

I, Wm. P. Rowland, Clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original Appendix to Brief for Petitioner, as constituting the portions of the record before this court at argument; and proceedings in this court, in the case of J. Robert Bazley, Petitioner, vs. Commissioner of Internal Revenue, Respondent, No. 8947, on file, and now remaining among the records of the said Court, in my office.

In Testimony Whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia,

this 26th day of June in the year of our Lord one thousand nine hundred and forty-six, and of the Independence of the United States the one hundred and seventieth.

Wm. P. Rowland, Clerk of the U. S. Circuit Court of Appeals, Third Circuit. (Seal.)

[fol. 149] Supreme Court of the United States, October Term, 1946

No. 287

Order Allowing Certiorari—Filed October 14, 1946

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted, and the case is assigned for argument immediately following No. 209, Adams vs. Commissioner.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.